

2023

Crossing the Abyss: A Comparative Analysis of the Enforceability of Preliminary Agreements

Marta Infantino

Larry A. DiMatteo

Jingen Wang

Eleni Zervogianni

Follow this and additional works at: <https://scholarlycommons.law.emory.edu/eilr>



Part of the [International Law Commons](#)

Recommended Citation

Marta Infantino, Larry A. DiMatteo, Jingen Wang & Eleni Zervogianni, *Crossing the Abyss: A Comparative Analysis of the Enforceability of Preliminary Agreements*, 37 Emory Int'l L. Rev. 629 (2023).

Available at: <https://scholarlycommons.law.emory.edu/eilr/vol37/iss4/3>

This Article is brought to you for free and open access by the Emory International Law Review at Emory Law Scholarly Commons. It has been accepted for inclusion in Emory International Law Review by an authorized editor of Emory Law Scholarly Commons. For more information, please contact law-scholarly-commons@emory.edu.

CROSSING THE ABYSS: A COMPARATIVE ANALYSIS OF THE ENFORCEABILITY OF PRELIMINARY AGREEMENTS

*Marta Infantino**

*Larry A. DiMatteo***

*Jingen Wang****

*Eleni Zervogianni*****

ABSTRACT

A major unresolved issue in international business transactions relates to the enforceability of preliminary agreements. Preliminary agreements cover a long list of instruments commonly used in most sectors of the economy. The common presumption is that these agreements are not enforceable. The correct answer is much more nuanced. For example, a preliminary agreement may be held to be unenforceable but at the same time be the basis for legal liability. There are strong differences between the civil and common laws on the issues of good faith negotiations and the enforceability of preliminary agreements, but there is also sustained uncertainty within legal systems. This article reviews Chinese, French, German, and Anglo-American law on the twin issues of enforceability and liability. It shows that the trend has been in favor of greater judicial scrutiny of such agreements that has led to greater enforceability and the expansion of available remedies, whether an agreement is deemed to be enforceable or unenforceable.

The issue of preliminary agreements and their place in the overall legal scheme has become less clear as courts have recognized their necessity as modern contract transactions have become more long-term and complex. The countries selected for review provide a three-part taxonomy. First, preliminary agreements are unenforceable due to the lack of certainty of terms and party

* Associate Professor of Comparative Private Law, Political Science Department, University of Trieste.

** Huber Hurst Professor of Contract Law, Warrington College of Business & Levin College Law at the University of Florida.

*** Associate Professor of International Business Law at TSL Business School, Quanzhou Normal University; Fellow at Center for International Banking Law & Practice, China University of Political Science & Law.

**** Associate Professor of Civil Law, Faculty of Law, Aristotle University of Thessaloniki.

intent. Second, preliminary agreements that are detailed may be recognized as enforceable contracts. Third, there is a broad middle area in which preliminary agreements are unenforceable as a whole but can be the basis for liability for independent obligations found in the agreements. These independent obligations include an implied-in-law or an implied-in-fact obligation to negotiate in good faith, duty of confidentiality, and duty of exclusivity to not negotiate with other parties. It is in this middle area where there has been a convergence in legal systems and, at the same time, where the issues of liability and remedies have become more uncertain. Because of the ubiquity of these agreements, the possibility of unexpected liability remains pronounced in international business negotiations.

TABLE OF CONTENTS

I. INTRODUCTION	631
A. <i>Types of Precontractual Liability</i>	633
B. <i>Civil-Common Law Divide</i>	634
C. <i>Preliminary Instruments (Agreements)</i>	638
II. PRELIMINARY AGREEMENTS AND PRECONTRACTUAL LIABILITY IN GERMAN LAW	640
A. <i>Overview of the German Rules on Contract Formation</i>	641
B. <i>Precontractual Liability</i>	643
C. <i>Types of Preliminary Agreements and Their Legal Effects</i>	645
1. <i>Pre-contracts</i>	645
2. <i>Option Agreements</i>	646
3. <i>Pre-Emption Agreements</i>	646
4. <i>Framework Agreements</i>	647
5. <i>Letters of Intent</i>	648
6. <i>Instructions to Proceed</i>	649
D. <i>Matter of Interpretation</i>	649
III. ENFORCEABILITY AND LIABILITY OF PRELIMINARY AGREEMENTS IN FRENCH LAW	652
A. <i>Overview of French Law on Contract Formation</i>	653
B. <i>Negotiations and Preparatory Agreements</i>	656
1. <i>Pre-emption Agreements and Firm Offers</i>	656
2. <i>Framework Agreements and Agreements to Agree</i>	657
3. <i>Letters of Intent and Agreements in Principle</i>	658
C. <i>A Matter of Interpretation</i>	659
IV. ENFORCEABILITY AND LIABILITY OF PRELIMINARY	

AGREEMENTS IN CHINESE LAW 662

A. *Preliminary Agreement in China: An Overview* 662

B. *Enforceability of Preliminary Agreements* 664

C. *Liability for Breach of Preliminary Agreement* 666

 1. *Fault-based Liability and Strict Liability* 666

 2. *Remedies for Breach of Preliminary Agreement* 667

V. PRELIMINARY AGREEMENTS IN ANGLO-AMERICAN LAW 671

A. *Introduction* 671

B. *Negotiations and Preparatory Agreements* 673

C. *Matter of Interpretation* 674

 1. *Presumption of Nonenforceability* 674

 2. *Content and Context* 676

D. *Spectrum of Preliminary Agreements* 677

 1. *Agreement to Negotiate in Good Faith or Agreement to Agree* 678

 2. *Promise, Reliance Theory, and Promissory Estoppel* 682

VI. FINDINGS AND TRENDS..... 685

A. *Enforceability of Preliminary Agreements* 685

B. *Remedies for Breach of Preliminary Agreements* 687

CONCLUSION 688

I. INTRODUCTION

The word “abyss” in the current context refers to crossing the line from no liability to full contractual liability. The abyss signifies that once a contract is formed, there is no going back; if a party fails to perform, it is liable for compensatory damages, including lost profits. Before that moment, there is no contractual liability. Although elegant in theory, the line demarcating the crossover is a blurry one and becomes exceptionally blurry whenever the parties enter into some form of preliminary agreement. Given the common use of such agreements in domestic and transnational business practice,¹ the issue of their bindingness is of great importance.

The development of contract law is guided by numerous norms such as freedom, justice, fairness, efficiency, and certainty.² This composite of norms is

¹ Larry A. DiMatteo, *Justice, Fault, and Efficiency in Contract Law*, 3 ITALIAN L.J. 37, 42 (2017).

² *Id.* at 38.

balanced differently throughout contract law. The areas of contract formation and formalities (writing requirements) are heavily weighted to promote certainty and predictability in the law. The genuineness of consent (coercion, mistake, misrepresentation), principle of unconscionability, excuse, hardship, and the duty of good faith are areas that advance the norms of justice and fairness.³ There are numerous areas of contract law in which the normative composite underlying its rules and principles remains unsettled. These areas are inflection points where the tensions between rival norms are at their strongest. These inflection points are most obvious when discussing divergences between the civil and common laws but are also apparent across civil and common law legal systems. These areas of law are characterized by uncertainty and variations in judicial outcomes. This uncertainty continues through time as these areas remain the focus of scholarly and judicial debate. It is exacerbated as the methods of doing business and types of contracts continuously change, which increases normative tensions. One of these areas concerns the precontractual stage.⁴

The issue that arises relates to whether parties in precontractual negotiations can be liable to each other and under what rules. This is the problem of precontractual liability. While civil law countries recognize liability for bad faith negotiations, the common law emphasizes the importance of formalities and the freedom to terminate negotiations.⁵ In complex transactions involving extensive negotiations, the parties often create preliminary agreements. The issue then arises whether the parties have crossed the abyss, that is, whether the preliminary agreement can be enforced and to what extent. Here the tensions are between the norms of certainty and predictability versus those of justice and fairness. To provide certainty and predictability in contract law, there should be a bright line rule that liability only attaches when a contract is formed weighs in favor of the unenforceability of such agreements. On the other hand, harm may occur when a party reasonably relies on the other party's promises made during the negotiation stage. A bad faith termination of negotiations or act by one of the other parties may cause unnecessary harm to the other.

³ See ROBERT HILLMAN, RICHNESS OF CONTRACT: AN ANALYSIS AND CRITIQUE OF CONTEMPORARY THEORIES OF CONTRACT LAW 4 (Aleksander Peczenik & Frederick Schauer eds., 1997); Larry A. DiMatteo, *The Norms of Contract: The Fairness Inquiry and the 'Law of Satisfaction'—A Nonunified Theory*, 24 HOFSTRA L. REV. 349, 368–69 (1995).

⁴ See LARRY A. DIMATTEO, INTERNATIONAL BUSINESS LAW AND THE LEGAL ENVIRONMENT: A TRANSACTIONAL APPROACH 313–316, 334–343 (4th ed. 2021); John Cartwright & Martijn Hesselink, *Conclusions*, in PRECONTRACTUAL LIABILITY IN EUROPEAN PRIVATE LAW 449, 450–70 (John Cartwright & Martijn Hesselink eds., 2008).

⁵ DIMATTEO, *supra* note 4, at 334–43.

As the article will make clear through the comparison of German, French, Chinese, and Anglo-American rules on precontractual liability, legal systems adopt different criteria to determine the enforceability of preliminary agreements and to assess precontractual liability. Differences across legal systems on this issue are meaningful because they create the potential for unexpected liability (in tort or contract) for parties from different legal systems. In some cases, differences are so acute that they might surprise not only the negotiating parties but also seasoned lawyers who are not familiar with the technicalities of foreign jurisdictions. This becomes more problematic when parties create preliminary agreements before agreeing on applicable law and forum for the resolution of disputes. Potentially, these disputes may be brought before any court with jurisdiction over the claim, which will use local conflict of law rules to determine the applicable law. Businesspersons and lawyers drafting international commercial contracts need to know when a preliminary agreement will be deemed to be binding across jurisdictions. The focus of this article is a comparative analysis of the law of four legal systems: Anglo-American, Chinese, French, and German. They were chosen due to their economic relevance and legal influence, as well as being representative of the civil law-common law divide.

The rest of this introduction provides background for the article's examination of the enforceability of preliminary agreements across civil and common law jurisdictions, including types of precontractual liability civil-common law divides, and a review of types of preliminary instruments. Parts II-IV will analyze, respectively, the German, French, and Chinese law of precontractual liability. They will show that the law of preliminary agreements is still developing, with the majority view being that such agreements include an implied obligation to negotiate in good faith to conclude a final contract. Part V examines Anglo-American common law. It discusses the emergence of promissory estoppel in American law and a growing recognition of agreements to negotiate in good faith in both American and English law.⁶ Part VI presents the findings of the comparative analysis of these civil and common law countries.

A. *Types of Precontractual Liability*

The area of precontractual liability is divisible into two types of cases. The first set of cases deals with impropriety in the negotiation of contracts. This area

⁶ See *infra* Section V.D.2.

of potential liability relates to the simple question of whether the parties have a duty to negotiate in good faith. The second set of cases involves the use of preliminary instruments or agreements⁷ during the negotiation phase. The more complicated question here is whether these preliminary instruments are enforceable or, more broadly, if they can be the basis for liability. This article focuses on the latter set of cases. That said, it is also important to note that the question of good faith negotiations cannot be completely unlinked from the issue of the enforceability of preliminary agreements. For instance, some courts have discussed whether a preliminary agreement can be interpreted as a separate agreement to negotiate in good faith. That is, is an agreement to negotiate in good faith an enforceable contract?

B. *Civil-Common Law Divide*

The enforceability of preliminary agreements is a longstanding debate in legal scholarship and, increasingly, in judicial decisions.⁸ The differences between civil and common law on this issue are often referred to as the civil-common law divide.⁹ The popular starting point is that the common law opposes precontractual liability, while the civil law systems recognize cause of actions related to the negotiation stage of contracting.¹⁰ But the reality is much more nuanced as will be seen in comparing the two common law systems (American and English), two core civil law systems (France and Germany), as well as China's *sui generis* civil law system.¹¹ The article focuses on the evolution of a

⁷ The words “agreement” and “instrument” will be used interchangeably throughout the article. Instrument is a broader, and plausibly a better term, than agreement for many preliminary instruments do not use the word agreement. Nonetheless, nomenclature aside, all such instruments are based on some level of agreement.

⁸ Much litigation has arisen in recent years out of the practice of making preliminary agreements. See E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 189 (4th ed. 2004).

⁹ See, e.g., MATHIAS SIEMS, COMPARATIVE LAW 50–81 (3rd ed. 2022); THOMAS LUNDMARK, CHARTING THE DIVIDE BETWEEN COMMON AND CIVIL LAW 37 (2012); KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW (3rd ed. 1998); H. PATRICK GLENN, LEGAL TRADITIONS OF THE WORLD 132–79, 236–86 (5th ed. 2014).

¹⁰ See Bürgerliches Gesetzbuch [BGB] [Civil Code], § 311, para. 2 (Ger.) (recognizing *culpa in contrahendo* or precontractual fault as potentially creating obligations); see also Reiner Schulze, § 311, in GERMAN CIVIL CODE 470–72 (Gerhard Dannemann & Reiner Schulze eds., 2020) (explaining of doctrine of *culpa in contrahendo*). *Culpa in contrahendo* is a Latin phrase meaning “fault in negotiating”; the notion has its roots in Roman Law. Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 407, 419 (1964).

¹¹ On January 1, 2021, the Chinese first grand civil code went into effect, which aligns Chinese legal system with the Western civil law tradition. ZHONGHUÁ RÉNMIN GONGHÉGUÓ MÍNFA DIǎN [CIVIL CODE OF THE PEOPLE’S REPUBLIC OF CHINA] [CCC] art. 1260 (promulgated by the Third Session of the Thirteenth National People’s Congress, May 28, 2020, effective Jan. 1, 2021). However, Chinese law has also been impacted by the common law. Chinese law has also recognized the importance of caselaw, first in the panwen case system prior

presumption against enforceability (common law) and in favor of enforceability (civil law), the current state of the debate, and the recent and likely future expansion of precontractual liability.

The increased likelihood of precontractual liability in civil law versus the common law is due to the embrace, especially in the Germanic family of civil law, of the duty of good faith, including during precontractual negotiations.¹² The common law rejects this duty based on the belief that parties should be allowed to exit negotiations at any time, free of liability. The civil law's view of negotiations is partially based upon communitarian values of fairness, cooperation, and solidarity,¹³ while the common law sees negotiations as an adversarial undertaking in which parties extract concessions as part of a zero-sum game.¹⁴ These perspectives are grounded in different normative composites that explain the divergence between the civil and common laws. The civil law composite recognizes the importance of free negotiations but also heavily weighs its counterpoise as reflected in the norms of fairness, justice, and good faith. The common law obsesses on safeguarding the freedom of negotiations, which is interpreted as freedom to negotiate in bad faith, freedom of parties to change their minds on agreed terms, and freedom to terminate negotiations prior to the execution of a contract. However, common law judges are not impervious to arguments of injustice and have moved the law away from absolute freedom of negotiations.¹⁵

The mix of norms discussed above is balanced differently within legal systems, including those in the same legal tradition. For example, the United States has long recognized an implied general duty of good faith in the

to 206 B.C. to 208 A.D. and in modern times in the “Guiding Opinions” issued by the Supreme People’s Court. See Larry A. DiMatteo, ‘Rule of Law’ in China: *The Confrontation of Formal Law with Cultural Norms*, 51 CORNELL INT’L L.J. 391, 395–96 (2018); see also Mary Ip, *The Revised Contract Law and Its Implications on Consumerism in China*, 9 INT’L J. BUS. 42, 45 (2004) (claiming that Chinese law “has adopted and modified certain basic contract elements from the common law system”).

¹² See BGB, *supra* note 10, at §§ 157, 162, 226, 242, 275, para. 2, & 311, para. 3.

¹³ These values are particularly reflected in the BGB in rules on the principle of good faith and on hardship. BGB, *supra* note 10, at §§ 242, 275.

¹⁴ See *Walford v. Miles* [1992] 2 AC 128, 138 (HL) (appeal taken from Eng.).

¹⁵ See *infra* Sections V.E.1, V.E.2.

performance of contracts,¹⁶ while English law rejects any such duty.¹⁷ Regarding the enforceability of preliminary agreements, the two legal systems are, on the surface, in sync. Neither system recognizes a duty of good faith negotiations nor adopts a presumption of the non-enforceability of preliminary agreements. In general, the common law “has rejected a general duty to negotiate in good faith that exists in some civil law jurisdictions. This [is] based on concerns that it would chill negotiations, create uncertainty, and add undue pressure on parties to conclude their negotiations.”¹⁸

But the Anglo and American systems diverge in their application of the doctrine of promissory estoppel. While English courts exclusively apply promissory estoppel defensively in order to overcome a missing contract requirement (such as writings or consideration) to prevent an injustice resulting from nonenforcement, American courts apply promissory estoppel both offensively and defensively.¹⁹ Promissory estoppel in American law has evolved to include a cause of action to support liability based on a promise made during negotiations but did not culminate in a contract. The seminal American case on the use of promissory estoppel is *Hoffman v. Red Owl Stores, Inc.*,²⁰ where a party expended a considerable sum during the negotiation of a franchise agreement. The court held the franchisor liable for damages based on the expenditures of the prospective franchisee that were encouraged by the franchisor.²¹

A stark distinction can be drawn in the civil law’s recognition of bad faith negotiations or *culpa en contrahendo*,²² where liability is based on fault and the

¹⁶ The duty of good faith in the performance of contract is found in § 1-304 UCC (“Every contract or duty within the [Act] imposes an obligation of good faith in its performance and enforcement.”). The UCC was adopted by most US states by the early 1970s. It eventually was adopted by analogy in the common law of contracts. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. L. INST. 1981) [hereinafter RESTATEMENT SECOND].

¹⁷ “English law has hitherto declined to adopt a general principle of good faith.” Jack Beatson & Daniel Friedmann, *From ‘Classical’ to Modern Contract Law*, in GOOD FAITH AND FAULT IN CONTRACT LAW 3, 14 (Jack Beatson & Daniel Friedmann eds., 1997).

¹⁸ Albert H. Choi & George Triantis, *Designing and Enforcing Preliminary Agreements*, 98 TEX. L. REV. 439, 446 (2020) (citing STEVEN J. BURTON & ERIC G. ANDERSON, CONTRACTUAL GOOD FAITH: FORMATION, PERFORMANCE, BREACH, ENFORCEMENT 330–31 (1995)).

¹⁹ *Infra* Section V.C.2.

²⁰ 133 N.W. 2d 267 (1965).

²¹ Martin Hogg notes that the “Red Owl remedy has not been adopted in English law.” MARTIN HOGG, PROMISES AND CONTRACT LAW 187 (2011).

²² German legal scholar Rudolf von Jhering created the concept of bad faith negotiations in his 1861 article *Culpa in Contrahendo*. Rudolf von Jhering, *Culpa in contrahendo oder Schadenersatz bei nichtigen oder nicht zur Perfektion gelangten Vertr. . . . gen* [*Culpa in Contrahendo or Damages for Contracts that are Void or Not*

common law's rejection of a duty to negotiate in good faith. Liability is premised on a party intentionally, fraudulently, and in bad faith, preventing negotiations from being consummated in a formal contract. Examples of fault include: entering negotiations with no intention of concluding a contract, breaking off negotiations without justification; withholding information vital to the negotiation of the contract; engaging in fraudulent or coercive behavior; concealing an illegal purpose; violating government regulations; and using negotiations to obtain confidential information.²³ The legal consequences of bad faith negotiations differ by country, with French law treating it as a tort action²⁴ and Chinese law considering it a form of liability falling somewhere between tort and contract.²⁵ It is modeled on a pattern of contractual liability in German law, although it is not contractual liability as such.²⁶

The differences among legal systems regarding this issue are noteworthy because they can cause confusion, uncertainty, and unexpected liability for negotiating parties. Comparative analysis of contract law often reveals that many of the divergences between civil and common law are a matter of semantics rather than substance. First, similar legal concepts, principles, or rules may be shrouded by differences in the languages used to describe them and their placement in different areas of law. Thus, someone researching a specific rule within one legal system may not be able to find a counterpart in a foreign legal system due to different terminology and legal categorization. Second, even if rules in one system do not correspond to those in another, the underlying rationale for the rules may still be satisfied in both systems, and they may act as "functional equivalents."²⁷ Finally, while formal rules may diverge between legal systems, their application of those rules may not diverge as much. This is the distinction between "law in the books" and "law in action," or the difference

Brought to Perfection], in 4 JAHRBÜCHER FÜR DIE DOGMATIK DES HEUTIGEN RÖMISCHEN UND DEUTSCHEN PRIVATRECHTS I (1861).

²³ It is best practice in cases where negotiations involve the sharing of information that the parties enter into a confidentiality agreement, which can appear as a provision in a preliminary agreement. Confidentiality and non-disclosure agreements are generally considered to be binding obligations.

²⁴ *Infra* Section III.A.

²⁵ *Infra* Section IV.C.

²⁶ *Infra* Section II.B.

²⁷ The functional method of comparative law is premised upon the idea that apparent differences between legal systems often disguise similar outcomes. Zweigert & Kötz explain that the principle of functionality rests on the knowledge that "the legal system of every society faces essentially the same problems and solves these problems by quite different means though very often with similar results." ZWEIGERT & KÖTZ, *supra* note 9, at 34.

between formal and operative rules.²⁸ Divergences in black letter law may not be replicated when applying those rules in practice. This article will assess whether the divergences across legal systems are as severe as the formal law seems to indicate.

C. Preliminary Instruments (Agreements)

The core issue to be examined is whether a preliminary agreement can be the basis for liability.²⁹ Farnsworth uses “the term ‘preliminary agreement’ to refer to any agreement, whether or not legally enforceable, that is made during negotiations in anticipation of some later agreement.”³⁰ Preliminary agreements include letters of intent,³¹ commitment letters,³² binders,³³ agreements in principle,³⁴ memoranda of understandings,³⁵ and heads of agreement,³⁶ as well

²⁸ See Elizabeth Warren, *Formal and Operative Rules under the Common Law and Code*, 30 UCLA L. REV. 898 (1983); see also Larry A. DiMatteo & Bruce L. Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law in Action*, 33 FLA. ST. U. L. REV. 1067 (2006) (explaining that empirical analysis shows that the doctrine of unconscionability, generally taught as a substantive fairness principle, is, in fact, a consent doctrine).

²⁹ It is well-settled that “the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their informal agreement from taking effect prior to that event.” *V’Soske v. Barwick*, 404 F.2d 495, 499 (2d Cir. 1968); see also *Bear Stearns Inv. Prods. v. Hitachi Auto. Prods. (USA)*, 401 B.R. 598, 618 (S.D.N.Y. 2009).

³⁰ E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 249 (1987).

³¹ Letters of intent (LOI) are used in numerous industries. One common use is found in the commercial leasing and commercial lending business. A borrower attempting to receive a commercial loan to build a commercial building obtains a letter of credit from prospective tenants to encourage the bank to make the loan.

³² Commitment letters are found in the field of real estate financing and may be binding on the bank, but not the borrower.

³³ In the insurance industry, binders are temporary insurance policies that provide coverage until the issuance of the full policy.

³⁴ Agreement in principle occur when the parties agree on the general terms that will be used in the final contract.

³⁵ Memorandum of Understanding (MOU) are often used in large transactions, such as a merger of companies. MOU is an agreement between parties outlined in a formal document, which is not legally binding but signals the willingness of the parties to move forward with a contract.

³⁶ Heads of Agreement, an English term, is a type of outline of an agreement. See *Morton v. Morton* [1942] 1 All ER 273 at 274 (Eng.); FARNSWORTH, *supra* note 8, at 249–50.

as term sheets,³⁷ comfort letters,³⁸ attorney opinion letters,³⁹ and so forth.⁴⁰ Preliminary agreements are found in most sectors of business and industry. They all have in common that they are preliminary to a more formal or follow-up contract.

Preliminary agreements vary from generally and vaguely worded to highly negotiated with detailed terms. Most preliminary agreements are not fully enforceable, standalone contracts. Many are internally contradictory, using promise and disclaimer of liability language.⁴¹ Deciphering the meaning of their language and, more importantly, the parties' intent is also perplexing. In the end, meaning and intent are implied through analyzing content and context.⁴² Common law courts have favored treating such instruments as non-binding if they contain any hint of disclaimer or intent to enter into a future, more formal agreement.⁴³ Civil law courts have shown greater flexibility and willingness to do a deeper analysis in determining if preliminary agreements contain binding obligations.⁴⁴ Whether a preliminary agreement is binding, such as an agreement to negotiate in good faith, is often based on the context of the agreement.⁴⁵ A preliminary agreement in one industry or trade may be considered non-binding, while it is viewed as binding in another.

For example, a missing material term in a preliminary agreement generally leads to the conclusion of unenforceability due to indefiniteness. But this is not always true. A California court held that a missing term alone is not enough to render a preliminary agreement unenforceable.⁴⁶ The court reasoned that the omission of the work and price terms was a commercial practice in the

³⁷ Term sheets show the terms or conditions of an investment. They are used by venture capitalists and/or by parties in a merger or acquisition.

³⁸ Comfort letters are given by parent companies to encourage banks to lend money to an independent subsidiary without giving a formal guarantee. See Larry A. DiMatteo & René Sacasas, *Credit and Value Comfort Instruments: Crossing the Line from Assurance to Legally Significant Reliance and Toward a Theory of Enforceability*, 47 BAYLOR L. REV. 357, 358 (1995); Jeffrey J. Gilbert, *Comfort Letters: A Banker's View*, 64 J. COM. BANK LENDING 48 (1982).

³⁹ See ROBERT A. THOMPSON, REAL ESTATE OPINION PRACTICE (3d ed. 1993).

⁴⁰ FARNSWORTH, *supra* note 8, at 231.

⁴¹ Larry A. DiMatteo, *The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Dealings*, 22 YALE J. INT'L L. 111, 114 (1997) ("They are hypocritical instruments intended to serve two masters. While wanting to avoid liability for nonperformance, the writer hopes the receiver of the writing will enter into a legally binding transaction.").

⁴² *Infra* Sections V.D.1, V.D.2.

⁴³ *Infra* Section V.D.1.

⁴⁴ *Infra* Sections II.D, III.C.

⁴⁵ *Infra* Section V.D.2.

⁴⁶ L.A. Unified Sch. Dist. v. Torres Constr. Corp., 57 Cal. App. 5th 480, 491 (2020).

construction industry and were often agreed upon after the signing of the contract.⁴⁷

These internally conflicted agreements (promise and disclaimer) are generally presumed to be unenforceable with two exceptions. In cases where the parties intended to execute a subsequent contract, some courts have held that the intent to formalize an agreement does not prevent a finding that the earlier agreement is an enforceable contract.⁴⁸ The second and more interesting exception is whether a preliminary agreement can bind the parties to continue to negotiate in good faith. The enforceability of preliminary agreements tests the two possible avenues of liability found in contract law—promise and reliance.⁴⁹ Contract law is primarily based upon the exchange of promises (or conduct) that show a general intent of the parties to enter into a binding contract. A single promise or assurance by one of the parties is insufficient to create a contract. The challenge to this promise-based regime is when a party reasonably relies on such a promise to its detriment, such as expending resources (time and expenses). Should contract law protect such reliance and allow the relying party a claim for damages if the promise is defaulted upon? This is the core question that lies behind the debate on the enforceability of preliminary agreements and is the focus of the current undertaking.

II. PRELIMINARY AGREEMENTS AND PRECONTRACTUAL LIABILITY IN GERMAN LAW

The basic rules on contract formation are included in the “General Part” (*Allgemeiner Teil*) of the German Civil Code, *Bürgerliches Gesetzbuch* (BGB), of 1900 in sections 145 through 156.⁵⁰ This regulation is mainly based on the model of offer and acceptance, subsequent to the negotiations of the parties. When negotiations are lengthy, as is often the case in complex transactions, the parties may conclude precontractual agreements that are not specifically regulated in the law but have evolved in practice. The legal effects of these arrangements are often unclear, as the line between binding and non-binding

⁴⁷ See Alex Linhardt, *Agreeing to Agree*, 44 L.A. LAW. 20, 22–23 (2021).

⁴⁸ See *Sawabeh Info. Servs. v. Brody*, 832 F. Supp. 2d 280 (S.D.N.Y. 2011) (holding that a preliminary term sheet was a binding contract).

⁴⁹ RESTATEMENT SECOND, *supra* note 16, § 75 (“[E]nforcement of bargains is . . . extended to the wholly executory exchange in which promise is exchanged for promise. . . . The promise is enforced by virtue of the fact of bargain[.]”); *id.* § 90 (“It is fairly arguable that the enforcement of informal contracts in the action of *assumpsit* rested historically on justifiable reliance on a promise.”).

⁵⁰ BGB, *supra* note 10, at §§ 145, 156.

preliminary agreements is blurry. Furthermore, non-binding agreements may give rise to pre-contractual liability. The sections below will examine the main rules on contract formation (section A) and pre-contractual liability (section B), before reviewing specific types of preliminary agreements (section C) and the way they are treated in judicial practice (D).

A. Overview of the German Rules on Contract Formation

Under German law, the sole requirement for the formation of a contract is the meeting of the will (intent) of the parties to enter into a binding legal relationship.⁵¹ This follows from the principle of *solus consensus obligat*. Thus, unlike common law or French law before its revision in 2016,⁵² there are no further prerequisites for the enforceability of contracts, such as consideration or legitimate cause (purpose).

The BGB regulates how contracts are made by offer and acceptance. Offer is the declaration of the will of one of the parties to the other, including all elements or terms necessary to conclude a particular contract (*essentialia negotii*).⁵³ Unless the offeror has stated otherwise, the offer is binding (cannot be withdrawn)⁵⁴ for the time stated in the offer⁵⁵ or the time that can be inferred by the circumstances.⁵⁶ A contract is concluded when the declaration of

⁵¹ HUGH BEALE ET AL., CASES, MATERIALS AND TEXT ON CONTRACT LAW 153 (2d ed. 2010). BGB Article 133 makes clear that the basis of a contract is subjective intent (meeting of minds) and not objective intent as found in the common law. It states: “When a declaration of intent is interpreted, it is necessary to ascertain the true intention rather than adhering to the literal meaning of the declaration.”

⁵² See *infra*, Sections V.B.1, III.A.

⁵³ See, e.g., MANFRED WOLF & JÖRG NEUNER, ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS § 37, ¶¶ 3–4 (11th ed. 2016); DIETER LEIPOLD, BGB I: ENFÜHRUNG UND ALLGEMEINER TEIL § 14, ¶ 2 (9th ed. 2017); REINHARD BORK, ALLGEMEINER TEIL DES BÜRGERLICHEN GESETZBUCHS § 18, ¶¶ 711–12 (4th ed. 2016). The offer is distinguished from the invitation to submit an offer (*invitatio ad offerendum*), which is not binding. The person who reacts to an invitation to offer and declares the will to conclude the contract is the offeror, and the contract is made after the acceptance of the offer by the person who had initiated the invitation. See, e.g., Bundesgerichtshof [BGH] [Federal Court of Justice] Jan. 12, 2011, Neue Juristische Wochenschrift Rechtsprechungs Report [NJW-RR] 462 (2011) (Ger.); WOLF & NEUNER, *supra*, § 37, ¶ 6; BORK, *supra*, § 18, ¶¶ 705–09. The interpretation of the declaration is thus crucial. See DIETER MEDICUS & JENS PETERSEN, ALLGEMEINER TEIL DES BGB ¶ 358 (11th ed. 2016); LEIPOLD, *supra*, § 14, ¶ 5.

⁵⁴ See BGB, *supra* note 10, at §§ 145–46.

⁵⁵ See BGB, *supra* note 10, at § 148.

⁵⁶ Section 147 of the BGB contains specific criteria on the duration of the binding effect of the offer. In the case of an offer made to a person who is present (orally or per telephone), the offeree should accept the offer “immediately” (in complex transactions, the term “immediately” is interpreted broadly). WOLF & NEUNER, *supra* note 53, § 37, ¶ 17; Reinhard Bork, § 147, in J. VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH: STAUDINGER BGB - BUCH I: ALLGEMEINER TEIL: §§ 139–63 ¶ 5 (Herbert Roth, Reinhard Bork & Sebastian Herrler eds., 2020). For an offer made (for instance, by letter or email) to a person who is absent, the

acceptance, mirroring the offer and addressed to the offeror, reaches the latter in a timely manner.⁵⁷ If the acceptance contains new or different terms from the offer, it qualifies as a counter-offer.⁵⁸

In principle, silence does not equal acceptance, unless the parties have agreed otherwise.⁵⁹ However, it is possible, depending on the circumstances and considering the principle of good faith, that the non-rejection of an offer by the recipient can be considered an acceptance.⁶⁰ Special rules may also give silence a specific meaning. A characteristic example, drawn from customary law, is the so-called “commercial letter of confirmation” (*kaufmännische Bestätigungsschreiben*), more generally referred to as a written confirmation.⁶¹ In business transactions, after the completion of negotiations, it is common for one party to send correspondence that essentially states the content of the agreement but may also include minor modifications or additions. If the recipient does not object promptly, a contract is formed based on the terms of the confirmation.

In practice, especially when negotiations are lengthy, it is difficult to discern an offer from an acceptance. Moreover, complex transactions often deviate from the offer-acceptance model. The parties (or a third party) partake in a continuous drafting process, writing down the points they have agreed upon until all terms have been agreed to and approved as a whole.⁶² In the end, the conclusion of the contract is dependent on the meeting of will of the parties on all the terms. Thus,

time the offeror would expect to receive the acceptance under ordinary circumstances is crucial. *See* WOLF & NEUNER, *supra* note 53, § 37, ¶¶ 18–21 (analyzing the parameters that are considered in these cases); BORK, *supra* note 53, ¶¶ 10–15.

⁵⁷ According to §130(1) of the BGB, a declaration of will addressed to another party (here the acceptance) becomes effective at the time it reaches him. Section 151 of the BGB provides that a contract is concluded through mere acceptance, without the need to notify the offeror, only if such notification is not expected in usual practice or the offeror has declared that there is no need of notification. *See* WOLF & NEUNER, *supra* note 53, § 37, ¶¶ 35–43; MEDICUS & PETERSEN, *supra* note 53, ¶¶ 382–86; BORK, *supra* note 53, ¶¶ 746, 749.

⁵⁸ *See* BGB, *supra* note 10, §§ 150(1)–150(2) (explaining late acceptance and modified acceptance respectively).

⁵⁹ *See* WOLF & NEUNER, *supra* note 53, § 31, ¶ 14; MEDICUS & PETERSEN, *supra* note 53, ¶ 393.

⁶⁰ *See* WOLF & NEUNER, *supra* note 53, § 31, ¶ 15, § 31, ¶¶ 29, 33; *see also* MEDICUS & PETERSEN, *supra* note 53, ¶¶ 392–93; LEIPOLD, *supra* note 53, §14, ¶ 26.

⁶¹ *See* MEDICUS & PETERSEN, *supra* note 53, ¶ 440; WOLF & NEUNER, *supra* note 53, § 37, ¶ 48; LEIPOLD, *supra* note 53, § 14 ¶ 28. Special forms of these commercial letters of confirmations are regulated in the German Commercial Code. *See, e.g.*, *Handelsgesetzbuch [HGB] [Commercial Code]*, §§ 91a, 362 (Ger.).

⁶² *See* Detlef Leenen, *Abschluß, Zustandekommen und Wirksamkeit des Vertrages*, 188 *DAS ARCHIV FÜR DIE CIVILISTISCHE PRAXIS [ACP]* 381, 399 (1988); *see also* MEDICUS & PETERSEN, *supra* note 53, ¶ 394; WOLF & NEUNER, *supra* note 53, § 37, ¶ 2; BORK, *supra* note 53, ¶ 701.

irrespective of the particular mode of contract formation, if the mutual consent of the parties does not cover all terms, then the rules of dissent apply.

The BGB includes two provisions on dissent, which are significant for this article. Section 154 addresses overt dissent and stipulates that, when in doubt, the contract is not concluded if the parties have not agreed on all substantial terms.⁶³ It further states that if the parties have expressed an intention to conclude a contract in a formal writing, there is no binding agreement until the execution of that contract.⁶⁴ But these rules of interpretation are immaterial if the will of the parties indicates otherwise. As long as their agreement covers the essential terms, then a binding contract is formed.⁶⁵ Section 155 refers to hidden dissent, which provides that if the parties consider the contract concluded, although they have not actually reached an agreement on particular terms, a binding contract is formed.⁶⁶ The presumption is that, given the circumstances, they would have still entered a contract despite not agreeing to the missing terms. Any contractual gaps are then filled by means of interpretation or the application of default rules.⁶⁷

B. Precontractual Liability

It has long been accepted in Germany that, in cases of prolonged contract negotiations, the interests of the negotiating parties should be protected. Thus, although the initial version of the BGB failed to include provisions relating to precontractual liability, German case law embraced the doctrine of *culpa in contrahendo*, initially developed by Rudolf von Jhering,⁶⁸ that gained the status of customary law.⁶⁹ These rules were then codified in sections 311(2) and (3) of

⁶³ See BGB, *supra* note 10, §154.

⁶⁴ See WOLF & NEUNER, *supra* note 53, § 38, ¶ 11; LEIPOLD, *supra* note 53, § 14, ¶ 53; BORK, *supra* note 53, ¶ 776; Oberlandesgericht [OLG] [Higher Regional Court] Schleswig-Holstein, Feb. 27, 2015, 17 U 91-44, juris (Ger.); *infra* II.D. If the form is required by law, BGB § 154(2) does not apply, and the contract is voided under BGB § 125(1). See WOLF & NEUNER, *supra* note 53, § 38, ¶ 11.

⁶⁵ See LEIPOLD, *supra* note 53, § 14, ¶ 52; BORK, *supra* note 53, ¶¶ 763, 766, 769, 771, 777; MEDICUS & PETERSEN, *supra* note 53, ¶ 434.

⁶⁶ See BGB, *supra* note 10, §155.

⁶⁷ See LEIPOLD, *supra* note 53, § 14, ¶ 54; MEDICUS & PETERSEN, *supra* note 53, ¶ 434; BORK, *supra* note 53, ¶780; see also BGH, May 12, 2006, NJW 284 (2006) (explaining the priority of filling gaps by applications of default rules); *infra* II.D.

⁶⁸ Von Jhering, *supra* note 22.

⁶⁹ WOLFGANG FIKENTSCHER & ANDREAS HEINEMANN, SCHULDRECHT, ALLGEMEINER UND BESONDERER TEIL ¶ 86 (11th ed. 2017); Cornelia Feldmann, § 311, in J. VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH: STAUDINGER BGB - BUCH 2: RECHT DER SCHULDVERH. . .LTNISSE: §§ 311, 311A-C ¶ 98 (Cornelia Feldmann, Robert Schumacher & Dagmar Kaiser eds., 2018); Jan Busche, *Vorbemerkung zu* § 145, in 1

the BGB by the Reform of the Law of Obligations (*Schuldrechtsmodernisierung*) of 2002.⁷⁰ Section 311(2) BGB extends to the pre-contractual stage the obligation of negotiating parties to consider the rights and interests of each other, as provided in section 241(2) of the BGB. Hence, the opening of negotiations comes with various protective duties (*Schutzpflichten* or *Rücksichtspflichten*), such as the duty to provide information, the duty of loyalty,⁷¹ and the duty to abstain from unjustified interruptions of the negotiations,⁷² which will be discussed below.

More specifically, the principle that each party is free to break off negotiations without the need for justification is no longer considered applicable when one of the parties has culpably led the other to trust that an agreement will be reached. If the negotiations are then unjustifiably interrupted, there is a breach of the pre-contractual duty of good faith.⁷³ The party whose expectations have been frustrated may claim damages⁷⁴ covering its “negative interest,” meaning reliance losses.⁷⁵ Precontractual liability is implied-in-law, irrespective of any agreement of the parties, although the parties may concretize or enhance the duties to each other.⁷⁶

MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH: BGB ALLGEMEINER TEIL §§ 1-240 BGB, ALLGEPERSÖNLR, PROSTG, AGG ¶ 58 (Claudia Schubert ed., 9th ed. 2021).

⁷⁰ Gesetz zur Modernisierung des Schuldrechts, Nov. 26, 2001, BUNDESGESETZBLATT, TEIL I [BGBL. I] at 3138 (Ger.).

⁷¹ The duty of loyalty is “*Treuepflicht*” in German. See Volker Emmerich, § 311, in 3 MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH ¶ 50 (8th ed. 2019); Busche, *supra* note 69, ¶ 58; BORK, *supra* note 53, ¶ 49.

⁷² There are various types of protective duties. See Feldmann, *supra* note 69, ¶¶ 121–64; Emmerich, *supra* note 71, ¶¶ 50, 60–70; FIKENTSCHER & HEINEMANN, *supra* note 69, ¶¶ 91–98.

⁷³ See Emmerich, *supra* note 71, ¶¶ 176–78; Feldmann, *supra* note 69, ¶¶ 143–45; see also BGH, Feb. 22, 1989, NJW-RR 627 (1989) (Ger.).

⁷⁴ BGB, *supra* note 10, § 280; see FIKENTSCHER & HEINEMANN, *supra* note 69, ¶ 88; LOTHAR HAAS ET AL., DAS NEUE SCHULDRECHT 124–25 (2002); BORK, *supra* note 53, ¶ 686; Roland Schwarze, § 282, in J. VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH: STAUDINGER BGB - BUCH 2: RECHT DER SCHULDVERH. . .LTNISSE: BGB §§ 255-304 ¶ 32 (Georg Caspers, Cornelia Feldmann, Sebastian Kolbe & Roland Schwarze eds., 2019) (Ger.).

⁷⁵ See FIKENTSCHER & HEINEMANN, *supra* note 69, ¶¶ 104–05; MEDICUS & PETERSEN, *supra* note 53, ¶ 454; HAAS ET AL., *supra* note 74, at 118; WOLF & NEUNER, *supra* note 53, § 36, ¶¶ 26, 38; Busche, *supra* note 69, ¶ 58. If the faulty interruption of negotiations prevents the formation of a valid contract that would otherwise have been concluded, there is, in principle, no claim for the conclusion of the contract. Feldmann, *supra* note 69, ¶ 175. The question here is whether one party can bring a claim against the other party (who interrupted negotiations) to force the latter to conclude the contract against its will (in German law this is called *Kontrahierungszwang*).

⁷⁶ See *infra* Section II.D.6.

C. *Types of Preliminary Agreements and Their Legal Effects*

Prior to entering a final or formal contract, the parties may enter into various preliminary agreements. The following review will discuss some significant types of such agreements. These preliminary agreements come in two types: agreements that are intended to lead to a final contract (Sections C.1.-C.5)⁷⁷ and agreements that are meant to control or regulate the negotiation process (Section C.6).⁷⁸

1. *Pre-contracts*

The most recognized binding preliminary agreement is the pre-contract (*Vorvertrag*), by which the parties, or at least one of them,⁷⁹ assume the obligation to conclude the main contract.⁸⁰ The *Vorvertrag* is not specifically regulated in the BGB. In the explanatory memorandum of the first draft (*Motive*) of the BGB, the regulation of the *Vorvertrag* was considered unnecessary since it is a fully binding contract, and the general rules on contracts apply.⁸¹ In practice, such agreements are common, especially in sales of immovables or contracts for work or services when parties agree to proceed with the contract despite issues remaining to be negotiated. Their content needs to be sufficiently specified, although not in every detail.⁸² According to case law, a *Vorvertrag* can be less definite than a formal contract,⁸³ where gaps can be filled through interpretation.⁸⁴ If the party bound by the *Vorvertrag* fails to conclude the final

⁷⁷ *Infra* Section C.1–C.5.

⁷⁸ *Infra* Section C.6.

⁷⁹ Pre-contracts may bind only one of the parties. See WOLF & NEUNER, *supra* note 53, § 36, ¶ 2; Busche, *supra* note 69, ¶ 66; MATTHIAS CASPER, DER OPTIONSVERTRAG 80–81 (2005); see also BGH, May 12, 2006, Neue Juristische Wochenschrift [NJW] 2843 (2006) (Ger.) (illustrated below under II.D).

⁸⁰ See Martin Otto, § 145 BGB Bindung an den Antrag, in 1 JURIS PRAXIS KOMMENTAR-BGB: ALLGEMEINER TEIL ¶ 49 (9th ed. 2020) (Ger.); BORK, *supra* note 53, ¶ 690. There is a presumption in favor of finding a contract, but not a pre-contract. See BGH, June 8, 1962, NJW 1812 (1962) (Ger.); Bork, *supra* note 56, ¶ 53.

⁸¹ See Busche, *supra* note 69, ¶ 61; Reinhard Bork, *Vorbemerkung zu § 145*, in STAUDINGER BGB - BUCH 1, *supra* note 56, ¶ 51 (citing MOTIVE ZU DEM ENTWURFE EINES BÜRGERLICHEN GESETZBUCHES FÜR DAS DEUTSCHE REICH I 178 (1888)).

⁸² A *Vorvertrag* includes the main terms of the final contract, and all of the other terms that the parties consider important. See DIETER HENRICH, VORVERTRAG, OPTIONSVERTRAG, VORRECHTSVERTRAG 127 (1965) (Ger.); BORK, *supra* note 53, ¶ 691; Busche, *supra* note 69, ¶ 63. In the case of an incomplete *Vorvertrag*, there remains an obligation to proceed to further negotiations. See HENRICH, *supra*, at 213; see also *infra* Section II.D.

⁸³ See BGH, Dec. 21, 2000, NJW 1285 (2001) (Ger.); Bork, *supra* note 81, ¶ 57; Busche, *supra* note 69, ¶ 63 (giving a more critical explanation).

⁸⁴ See BORK, *supra* note 53, ¶ 691; Busche, *supra* note 69, ¶ 64.

contract, the other party has a claim for specific performance.⁸⁵ The court, by granting specific performance, substitutes for the declaration of the will and acts to conclude the contract.⁸⁶ Because of its binding effect, the pre-contract is subject to the same form requirements as found in final contracts of the same type.⁸⁷

2. Option Agreements

Another form of a binding preliminary contract is the option agreement (*Optionsvertrag*), which grants one party the unilateral right to conclude the contract, the contents of which have been fully negotiated and incorporated into the option agreement. For this reason, the option agreement (but not the exercise of the right of option) is subject to the same form requirements as the main contract.⁸⁸ A special form of the *Optionsvertrag* regulated in the BGB is the *Wiederkauf* (§§ 456-462, which recognizes the seller's right to repurchase the object of the sale from the buyer. A functional equivalent of the option agreement is the firm offer (*Festofferte*) that may be binding for a long period of time.⁸⁹ Unlike the option agreement, the terms of the offer are not agreed upon but are decided by the offeror alone. Finally, the option agreement is often difficult to discern from a pre-contract (*Vorvertrag*) that is binding on only one of the parties. The difference lies in the effect of the declaration of the will of a party to conclude a main contract: if it leads directly to the conclusion of the contract, then it is an *Optionsvertrag*, but if one party has a claim against the other to proceed to the conclusion of the contract, then the agreement qualifies as a *Vorvertrag*.⁹⁰

3. Pre-Emption Agreements

Pre-emption agreements (*Vorrechtverträge*) grant one of the parties privileges over third persons if the other party decides to proceed to the conclusion of a specific contract.⁹¹ A specific type of pre-emption agreement is

⁸⁵ See Zivilprozessordnung [ZPO] [Code of Civil Procedure], § 894 (Ger.).

⁸⁶ *Id.*

⁸⁷ See BGH, May 12, 2006, NJW 2843 (2006) (Ger.) (illustrated below under Section II.D); see also Busche, *supra* note 69, ¶ 65; Bork, *supra* note 81, ¶ 60; WOLF & NEUNER, *supra* note 53, §36, ¶ 4.

⁸⁸ See NJW 2843 (2006) (Ger.); Otto, *supra* note 80, ¶ 56; BORK, *supra* note 53, ¶ 697.

⁸⁹ See WOLF & NEUNER, *supra* note 53, §36, ¶ 6; Otto, *supra* note 80, ¶ 57; BORK, *supra* note 53, ¶ 696; Busche, *supra* note 69, ¶ 74.

⁹⁰ See Bork, *supra* note 81, ¶ 69; CASPER, *supra* note 79, at 81–82; Christian Armbrüster, *Vorbemerkung vor § 145*, in ERMAN BGB, KOMMENTAR ¶ 51a (16th ed. 2020).

⁹¹ See CASPER, *supra* note 79, at 82.

a *Vorhandveträge*, which allocates to one party the obligation to grant a preference to the other party. A *Vorhandveträge* can come in various forms, which differ in terms of their binding effect. In their weakest version, a party must notify the beneficiary of the intention to conclude the main contract, allowing the beneficiary to make an offer that the former is free to accept or deny.⁹² The right of pre-emption is stronger when the beneficiary has the right to finalize the contract. This is the case when either the beneficiary has the right to claim the conclusion of a contract when its offer matches the best offer or when the beneficiary has the right to be the first party to receive a binding offer (*Angebotsvorhand*).⁹³ In the latter, the agreement between the parties is a type of *Vorvertrag* binding upon one of the parties, provided the other party decides to enter into the contract.⁹⁴

Another type of pre-emption agreement, regulated in the BGB, is a special type of sales contract called a *Vorkauf*.⁹⁵ A *Vorkauf* allows the beneficiary to exercise the right of pre-emption when the other party concludes a sales contract with a third party.⁹⁶ As a result, a sales contract is concluded between the seller and the holder of a *Vorkaufsrecht* on the same terms as the sales contract with the third party.⁹⁷

4. Framework Agreements

The framework agreement (*Rahmenvertrag*) is considered preliminary to a series of future contracts. Parties enter into such agreements when they intend to establish a long-term business relationship where future contracts are formed subject to the terms of the framework agreement. Framework agreements are often used in factoring and franchising relationships.⁹⁸ The *Rahmenvertrag* regulates the rights and obligations of the parties involved in the relationship as well as issues relating to future contracts. As a rule, a party cannot bring a claim for the failure to conclude future contracts. However, the unjustified denial to

⁹² See HENRICH, *supra* note 82, at 304–07; Bork, *supra* note 81, ¶ 78; Otto, *supra* note 80, ¶ 59.

⁹³ See HENRICH, *supra* note 82, at 303; WOLF & NEUNER, *supra* note 53, § 36, ¶ 11.

⁹⁴ See BGH, Dec. 17, 1987, NJW 1261 (1988) (Ger).

⁹⁵ BGB, *supra* note 10, §§ 463–73.

⁹⁶ *Id.* § 463.

⁹⁷ BGB, *supra* note 10, § 464(2).

⁹⁸ See Bork, *supra* note 81, ¶ 54; WOLF & NEUNER, *supra* note 53, § 36, ¶ 14; Armbrüster, *supra* note 90, ¶ 55.

conclude future contracts may constitute a breach of the framework agreement and warrant a claim for damages.⁹⁹

5. *Letters of Intent*

Letters of intent are used primarily in complex transactions, such as sales of businesses and investment projects. They come in different forms and feature different content depending on the type of business or transaction.¹⁰⁰ A common denominator is that one party expresses the non-binding, in principle, intention to proceed with the conclusion of a contract under certain conditions.¹⁰¹ A letter of intent may also recite the terms on which the parties have already agreed, called a *Punktation*,¹⁰² as well as terms to be agreed upon.

The non-binding character of such promises or agreements is only the starting point of the analysis. A bilateral letter of intent may include binding agreements relating to the negotiation process, such as a duty of confidentiality, commitment to exclusive negotiations, or obligations to pay break-up fees.¹⁰³ In exceptional cases, the conclusion of a *Vorvertrag* or a final contract may be inferred.¹⁰⁴ However, this inference is unlikely in cases where the parties make clear their intention not to be bound unless performance has begun.¹⁰⁵ Even without a binding effect, letters of intent enhance the recipient's trust that the negotiations will not be interrupted without sound reasons and support a claim for breach of the duty of good faith negotiation.¹⁰⁶ Thus, there is always the possibility that these agreements may result in pre-contractual liability, including claims for damages for costs incurred (reliance damages).¹⁰⁷

⁹⁹ See BGH, Apr. 30, 1992, NJW-RR 977 (1992) (Ger.); CASPER, *supra* note 79, at 87; WOLF & NEUNER, *supra* note 53, § 36, ¶ 16; Armbrüster, *supra* note 90, ¶ 55.

¹⁰⁰ See MARCUS LUTTER, *DAS LETTER OF INTENT* 3–4 (3d ed. 1998). The terminology is volatile and does not clearly distinguish between letters of intent, memoranda of understanding, and instructions to proceed. See Otto, *supra* note 80, ¶ 58; Busche, *supra* note 69, ¶ 60. According to Marcus Lutter, instructions to proceed falls within the notion of letter of intent. LUTTER, *supra*, at 45.

¹⁰¹ See Busche, *supra* note 69, ¶ 59; LUTTER, *supra* note 100, at 37; CASPER, *supra* note 79, at 75; Bork, *supra* note 56, ¶ 14.

¹⁰² See Busche, *supra* note 69, ¶ 60; Bork, *supra* note 56, ¶ 14; BGB, *supra* note 10, § 154(1), sentence 2 (also mentioned under Section II.A).

¹⁰³ See *infra* Section II.C.6.

¹⁰⁴ LUTTER, *supra* note 100, at 24–25; Busche, *supra* note 69, ¶ 60.

¹⁰⁵ See LUTTER, *supra* note 100, at 22–23.

¹⁰⁶ See LUTTER, *supra* note 100, at 69–79; MEDICUS & PETERSEN, *supra* note 53, ¶ 455; Bork, *supra* note 56, ¶ 14.

¹⁰⁷ See Busche, *supra* note 69, ¶ 59; CASPER, *supra* note 79, at 76.

6. *Instructions to Proceed*

The “instructions to proceed” are binding preliminary agreements that do not refer to the negotiated contract’s contents but regulate the negotiating process itself.¹⁰⁸ They include the obligations of confidentiality, exclusivity of negotiations, and a duty to disclose information.¹⁰⁹ The breach of these instructions or obligations leads to liability. Due to the difficulty in proving damages, these agreements often stipulate the damages to be paid.

D. *Matter of Interpretation*

The distinctions between the different types of preliminary agreements presented are not clear. This is because preliminary agreements differ in content, so the title of the agreement is not dispositive of the nature of the agreement. What is crucial for the binding character and the enforceability of the agreement is interpretation. The starting point for interpretation is the subjective will or intent of the parties.¹¹⁰ If there is no such common will, then objective criteria, such as good faith or trade usage, are used to determine intent.¹¹¹ The binding nature of the declaration of the will of each party is determined through the perspective of the reasonable third person (*objektiven Empfängerhorizont*).¹¹² Factors used in determining party intent include the wording of the agreement, economic purpose of the agreement, interests of both parties, as well as any other relevant circumstances.¹¹³ If it remains doubtful whether the parties have concluded a binding contract, section 154 of the BGB provides a presumption against enforceability.

¹⁰⁸ See CASPER, *supra* note 79, at 77; cf. WOLF & NEUNER, *supra* note 53, § 36, ¶ 13.

¹⁰⁹ Such clauses may be also included in a letter of intent. See *supra* II.C.5.

¹¹⁰ The declaration of will is explained in BGB, § 133. BGB, *supra* note 10, §133; see Busche, *supra* note 69, ¶ 15; Hermann Reichold, § 133, in 1 JURIS PRAXIS KOMMENTAR-BGB, ¶ 18 (9th ed. 2020) (Ger.); Events after the conclusion of the agreement can be also considered, which is important when the actions are inconsistent with the declared will. Reichold, *supra*, ¶ 18; LEIPOLD, *supra* note 533, §15, ¶ 13.

¹¹¹ See BGB, *supra* note 10, §157. The wording of the provision refers to the interpretation of contracts, but it is generally accepted that it applies to a unilateral declaration of will addressed to another person as well. See MEDICUS & PETERSEN, *supra* note 53, ¶¶ 321, 323; Reinhard Singer, § 133, in J. VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH: STAUDINGER BGB - BUCH 1: ALLGEMEINER TEIL: §§ 90–124; §§ 130–33 ¶ 3 (Malte Stieper, Steffen Klumpp, Reinhard Singer & Sebastian Herrler eds., 2021); Busche, *supra* note 69, ¶ 9.

¹¹² See Reichold, *supra* note 110, ¶ 12; MEDICUS & PETERSEN, *supra* note 53, ¶ 323; Busche, *supra* note 69, ¶ 12.

¹¹³ Reichold, *supra* note 110, ¶ 20–22; LEIPOLD, *supra* note 53, § 15, ¶¶ 10, 13, 17; Busche, *supra* note 69, ¶ 12.

Case law is generally reluctant to recognize the enforceability of agreements that are deemed to be indeterminate. The seminal judgment of the *Koblenz Court of Appeal (OLG)* of May 12, 2005, illustrates this point.¹¹⁴ The defendant sent a letter to the plaintiff-architect, declaring its intention to cooperate with her on a future project involving the construction of a school, under the condition that the architect draft construction plans without remuneration pending the State's approval of the project. In the same letter, the defendant stated that, in return, if the project were approved, it would assign the architectural work to the architect.¹¹⁵ The defendant was awarded a public tender for the construction of two buildings of the school. It then assigned the architectural work to another architect. The plaintiff-architect brought a claim for lost profits.

The court ruled that there was no valid preliminary agreement between the parties because the initial declaration was too vague and missing essential terms (*essentialia negotii*) and, as such, did not qualify as a *Vorvertrag*.¹¹⁶ The parties' understanding lacked specifications on the building, the time performance, and remuneration. Finally, the court noted there was a possible claim of plaintiff's reliance loss but left the issue undecided.

Agreement on essential terms is no guarantee that a binding agreement has been concluded. The judgment of *Schleswig-Holstein Court of Appeals (OLG)* from February 27, 2015, involved negotiations between an event agent and a local organizer for the sale of a stage production.¹¹⁷ The parties had reached an agreement on the place and date of the event as well as on the fees that the organizer would pay the agent. However, there were further issues to be decided, such as liability insurance and safety measures. As the negotiations failed to progress, the agent informed the organizer that it considered the agreement to be binding. The organizer replied that a full agreement still needed to be concluded. The agent waited two months before bringing a claim based on the alleged agreement or, alternatively, for pre-contractual liability due to unjustified interruption of the negotiations.

The court rejected the claim on both grounds.¹¹⁸ It ruled that, although the parties had agreed on the *essentialia negotii* of the contract, they had not reached

¹¹⁴ OLG Koblenz, May 12, 2005, 5 U 1408/04, juris (Ger.). Similar is the decision of OLG Frankfurt, Apr. 17, 2018, 5 U 32/17, juris (Ger.).

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ OLG Schleswig-Holstein, Feb. 27, 2015, 17 U 91/14, juris (Ger.).

¹¹⁸ *Id.*

an agreement on other terms, one of which the organizer had declared to be important. Therefore, according to section 154 of the BGB, no binding agreement was concluded. The court emphasized that in a *Vorvertrag* the terms must be precise enough so that, if a dispute arises, the court can ascertain them.¹¹⁹ Moreover, the parties had clearly expressed their intent to conclude the agreement in a formal writing and, according to section 154(2) of the BGB, such a writing would then be required.¹²⁰ The court also ruled that there was no pre-contractual liability since the organizer's behavior was reasonable and any expenses incurred by the agent were its own.¹²¹

These decisions show that the level of concretization (specification) of an agreement is essential for its enforceability, given the presumption against the binding character of incomplete agreements. This does not mean that a preliminary agreement is deemed binding only if it is complete. On May 12, 2006, the Federal Court of Justice (BGH), the highest court of Germany, heard a case about the owner of a plot of land with a commercial building, which the owner leased for a term of ten years, with a lessee option to buy to be exercised in writing.¹²² The initial agreement specified the price and the time of payment.¹²³ The lessee exercised the option in writing but subsequently failed to proceed to the conclusion of the sales contract.¹²⁴ The owner brought a claim against the lessee that included a detailed sale offer that the owner had drafted and requested that the lessee accept the offer.¹²⁵

The court ruled that the option agreement was a *Vorvertrag* that bound the owner if the lessee exercised its option to buy.¹²⁶ The fact that the option provision lacked detail, but did cover the essential terms of the sales contract, was sufficient for it to be binding.¹²⁷ Section 154 of the BGB's presumption against enforceability did not apply because the court found that the parties showed an intent to enter into a binding agreement and had assumed the obligation to negotiate the details at a later time.¹²⁸ Failure of the subsequent negotiations gives each party the right to bring a claim by submitting a contract

¹¹⁹ *Id.* ¶¶ 68–69; see BGB, *supra* note 10, § 154(1), sentence 2.

¹²⁰ OLG Schleswig-Holstein, Feb. 27, 2015, 17 U 91/14, ¶ 78, juris (Ger.).

¹²¹ *Id.* ¶¶ 81–82.

¹²² BGH, May 12, 2006, NJW 2843 (2006) (Ger).

¹²³ *Id.* ¶ 3.

¹²⁴ *Id.* ¶ 4.

¹²⁵ *Id.*

¹²⁶ *Id.* ¶ 13.

¹²⁷ *Id.*

¹²⁸ *Id.* ¶¶ 14–18.

proposal to the court. The court then decided the terms of the final contract based on its interpretation of the *Vorvertrag*, the parties' good faith duty to perform the obligations derived from the *Vorvertrag*, and applicable trade usage.¹²⁹

III. ENFORCEABILITY AND LIABILITY OF PRELIMINARY AGREEMENTS IN FRENCH LAW

An underdeveloped set of rules on contract formation were found in the French Civil Code (FCC) of 1804. The FCC, in its original enactment, devoted little attention to the matter of preliminary agreements. Over two centuries, French courts have provided a complex and thick set of principles to fill the gaps in the FCC. Many of these well-settled rules were codified and integrated into the FCC through a major reform of contract law adopted in 2016.¹³⁰ Since one of the main goals of the 2016 reform was to update the FCC's text to align with the judicial developments of the previous decades, French rules on contract formation are now consistent between statutory formulae and judicial principles.

The revised provisions of the FCC dealing with negotiations and contract formation (articles 1112–1124) acknowledge the duration of the contract-making process.¹³¹ The new FCC adopted existing case law governing the pre-contractual stage and the requirements for the creation of valid contracts.¹³² However, the new provisions do not cover all aspects of contractual negotiations and the progressive formation of contracts, which continue to be regulated by long-established case law. The next section reviews the basic features of the French legal approach to contract formation and validity.

¹²⁹ *Id.* ¶¶ 30–31.

¹³⁰ Ordonnance n° 2016-131 du 10 février 2016 portant réforme du droit des contrats, du régime général et de la preuve des obligations [Ordonance No. 2016-131 of February 10, 2016 Reforming Contract Law, the General Regime and Proof of Obligations] Journal Officiel de la République Française [J.O.] [Official Gazette of France] Feb. 11, 2016, Texte 26 (reforming contract law in the French Civil Code). The newly reformed rules only apply to disputes arising out of contracts agreed upon after Oct. 1, 2016. *Id.* art. 9.

¹³¹ Laura Sautonie-Laguionie, *The Creation of a Legal Theory of the Conclusion of the Contract*, in THE REFORM OF FRENCH CONTRACT LAW 69 (Bénédicte Fauvarque-Cosson & Guillaume Wicker eds., 2019); Ruth Sefton-Green, *Formation of Contract: Negotiation and the Process of Agreement*, in THE CODE NAPOLÉON REWRITTEN: FRENCH CONTRACT LAW AFTER THE 2016 REFORMS 59 (John Cartwright & Simon Whittaker eds., 2017).

¹³² STÉPHANIE PORCHY-SIMON, DROIT DES OBLIGATIONS 65 (14th ed, 2021); Sautonie-Laguionie, *supra* note 131, at 69–82; Sefton-Green, *supra* note 131, at 59.

A. *Overview of French Law on Contract Formation*

From the perspective of the common law, the foremost distinguishing feature of French contract law is that it does not require consideration to form a binding contract. The notion of *contrat* under French law is much wider than the corresponding notion of contract in the common law since French contract law covers unilateral undertakings, such as gift promises.¹³³ Before the 2016 reform, it was necessary that the contract rest upon a legitimate *cause* or *causa* for bilateral and unilateral contracts to be valid, that is, on a lawful reason.¹³⁴ The FCC of 2016 eliminated the requirement of *cause*, leaving agreement on a lawful and specific content by parties with full capacity and willingness to be bound as requirements to form a contract.¹³⁵ This new approach impacts the formation of unilateral *contrat* or unilateral obligations by clarifying the role of silence as a means of acceptance and providing for circumstances where offers are regarded as firm offers.

Under French law, a bilateral or unilateral contract is defined by Article 1101 of the FCC as “the concordance of wills of two or more persons intended to create, modify, transfer or extinguish obligations.”¹³⁶ This means that all parties must consent to the transaction even if the agreement creates obligations for only one of the parties. Article 1113 of the FCC states that a contract, whether bilateral or unilateral, “is formed by the meeting of an offer and an acceptance by which the parties demonstrate their will to be bound.”¹³⁷

A contract is concluded as soon as the acceptance reaches the offeror.¹³⁸ Mere silence by the offeree, under Article 1120 of the FCC, is not sufficient to form a contract.¹³⁹ Article 1120, however, provides that silence may constitute

¹³³ See also Code Civil [C. civ.] [Civil Code] arts. 1106–07 (Fr.) (defining unilateral and gratuitous contracts respectively).

¹³⁴ “Cause [...] becomes a description of what might be called the generalized motivation of the transaction; it does not require that the transaction, to be enforceable, contain an element of bargain or reciprocity.” Arthur von Mehren, *The French Civil Code and Contract: A Comparative Analysis of Formation and Form*, 15 LA. L. REV. 687, 688 n.3 (1955) (emphasis in original). Much ink has been spent on the similarities and differences between the requirements of consideration and cause. See, e.g., *id.* at 698–711; James Gordley & Hao Jiang, *Causa and Consideration*, in ELGAR ENCYCLOPEDIA OF COMPARATIVE LAW (Jan Smits, Catherine Valcke & Jaakko Husa eds., forthcoming 2023); von Mehren, *supra*, at 698–711; Ernest G. Lorenzen, *Causa and Consideration in the Law of Contracts*, 7 YALE L. J. 621 (1919).

¹³⁵ C. civ. art. 1128 (Fr.).

¹³⁶ *Id.* art. 1101.

¹³⁷ *Id.* art. 1113.

¹³⁸ *Id.* art. 1121.

¹³⁹ *Id.* art. 1120.

acceptance “where so provided by legislation, usage, business dealings or other particular circumstances.”¹⁴⁰ French courts have recognized that one of the “other particular circumstances” is when the contract is beneficial to the offeree—that is, the contract is unilateral and gives rise to obligations of the offeror.¹⁴¹

In principle, an offeror can withdraw the offer at any time, provided that the revocation is communicated to the offeree.¹⁴² An exception to this rule is when either the offeror sets a period for acceptance or when such period results from the circumstances of the case.¹⁴³ The withdrawal of the offer before the end of that period exposes the offeror to extra-contractual liability for reliance damages suffered by the offeree.¹⁴⁴ The withdrawal is effective to prevent the conclusion of a contract, but the offeror is not relieved of liability.¹⁴⁵ The offeror might make the offer irrevocable either for a consideration or gratuitously by entering into a contract of *promesse unilatérale*, under which the offeror is bound to keep its offer open for the period of time set in the offer.¹⁴⁶ In these cases, “[r]evocation of the promise during the period allowed to the beneficiary [(offeree)] to exercise the option does not prevent the formation of the contract” if the beneficiary decides to accept.¹⁴⁷ In such a case, the withdrawal of the offer is deemed to be unlawful and ineffective.¹⁴⁸ Even when gratuitous, the contract of *promesse unilatérale* is binding upon the offeror, while leaving the offeree free to decide whether to enter the contract.¹⁴⁹

A general feature of French law is its adherence to the principle of good faith, which applies thought to the contract process. Article 1104(1) of the FCC states,

¹⁴⁰ *See id.*

¹⁴¹ Cour de cassation [Cass.] [supreme court for judicial matters] req., Mar. 29, 1938, *Dalloz Pratique* 1939, I, 5 (Fr.). The rule is considered applicable even after the 2016 reform. *See* CODE CIVIL 2021 ANNOTÉ 1355 (2020) [hereinafter CC ANNOTÉ].

¹⁴² This is the usual understanding of Articles 1115 and 1116 of the French Civil Code. *See* C. civ. art. 1115–16.

¹⁴³ *See id.*

¹⁴⁴ C. civ. art. 1116(1)–(3) (Fr.). Article 1116(3) in particular specifies that the offeror cannot be held liable “for the loss of profits which were expected from the contract”—that is, the other party’s expectation interest. The rule corresponds to a principle long established by French courts. *See* Cass. 1e civ., Dec. 17, 1958, *Dalloz* 1959, I, 33 (Chastan v. Isler).

¹⁴⁵ *See id.*

¹⁴⁶ C. civ. art. 1124(1)–(3) (Fr.).

¹⁴⁷ *Id.* art. 1124(2).

¹⁴⁸ *See id.*

¹⁴⁹ *See id.*

“[c]ontracts must be negotiated, formed and performed in good faith.”¹⁵⁰ This provision is “a matter of public policy”¹⁵¹ that cannot be excluded by the parties. In comparison to the good faith principle in Germany, under French law, pre-contractual breach of good faith is not considered a contractual breach due to the principle of freedom of contract.

The balance between the principles of pre-contractual good faith and freedom of contract is expressed in Article 1112(1) of the FCC: “[t]he commencement, continuation and breaking-off of precontractual negotiations are free from control. [However, t]hey must mandatorily satisfy the requirements of good faith.”¹⁵² This means that parties are free to negotiate without restrictions if they behave in a good faith manner. Parties are free to stop negotiations but are not free to suddenly withdraw from advanced negotiations without a viable reason (*rupture abusive des pourparlers*).¹⁵³ Other illustrations of behaviour contrary to good faith in negotiations are codified in Articles 1112(1) and 1112(2) of the FCC. Article 1112(1) establishes a pre-contractual duty of one party to disclose important information to the other party that it is reasonably unaware of or information that the party legitimately relies on for the knowing party to provide the information.¹⁵⁴ Article 1112(2) establishes a duty not to disclose confidential information that one party has obtained during negotiations.¹⁵⁵ In these cases, any claims for damages would be in tort. The party in breach of the pre-contractual duty of good faith is only liable for the

¹⁵⁰ *Id.* art. 1104(1).

¹⁵¹ *Id.* art. 1104(2).

¹⁵² *Id.* art. 1121(1).

¹⁵³ The leading cases, all affirming the liability in tort of the party who suddenly exited from the negotiations, are Cass. com., Mar. 20, 1972, Bull. civ. IV, No. 96 (Fr.) (*Gerteis v. Vilber-Lourmat*); Cass. 3e civ., Oct. 3, 1972, Bull. civ. III, No. 491 (Fr.) (*Monoprix v. Résidence Bonaparte*); Cass. com., Nov. 26, 2003, Bull. civ. IV, No. 186 (Fr.) (*Manoukian v. X*). *See also* Cass. com., Jan. 7, 1997, N° de pourvoi 94-21.561, Inédit <https://www.legifrance.gouv.fr/juri/id/JURITEXT000007319876/> (Fr.) (*Eurolactique & Co. v. Banque franco-allemande*); Cass. com., Apr. 22, 1997, N° de pourvoi 94-18.953, Inédit, <https://www.legifrance.gouv.fr/juri/id/JURITEXT000007333202/> (Fr.) (*Mabo v. Iveco*); Cass. com., Apr. 7, 1998, N° de pourvoi 95-20.361, Inédit, <https://www.legifrance.gouv.fr/juri/id/JURITEXT000007373338/> (Fr.) (*Laboratoires Sandoz v. Poleval*); ISABEL ZULOAGA, RELIANCE IN THE BREAKING-OFF OF CONTRACTUAL NEGOTIATIONS 55–98 (2019); Cartwright & Hesselink, *supra* note 4, at 449; PAULA GILIKER, PRE-CONTRACTUAL LIABILITY IN ENGLISH AND FRENCH LAW 120–32 (2002); Patrice Jourdain, *Rapport Français, in LA BONNE FOI* 121–32 (Association Henri Capitant ed., 1994); Joanna Schmidt, *La période précontractuelle en droit français*, 42 REV. INT. DR. COMP. 545–66 (1990). *See generally* JOANNA SCHMIDT, NÉGOCIATIONS ET CONCLUSION DE CONTRATS (1982).

¹⁵⁴ C. civ. art. 1112(1) (Fr.).

¹⁵⁵ PORCHY-SIMON, *supra* note 132, at 65–66; Sautonie-Laguionie, *supra* note 131, at 72–75; Sefton-Green, *supra* note 131, at 61–69.

frustrated reliance interest rather than the expectation interest of the other party.¹⁵⁶

B. *Negotiations and Preparatory Agreements*

The FCC acknowledges that parties during their negotiations may conclude a variety of preliminary arrangements relating to a prospective final contract. These arrangements have historically been grouped in French scholarship under the category of preparatory agreements (*contrats préparatoires*) or pre-contracts (*avant-contrats*).¹⁵⁷ The *contrats préparatoires* qualify as binding contracts, a breach of which entails contractual (rather than tortious) liability. As stated in doctrinal texts, when evaluating the behaviour of parties during negotiations, a distinction should:

be made depending on whether a preparatory contract is concluded. In the absence of such a contract, contractual freedom prevails, even if obligations . . . are imposed on the negotiating parties, and the breach of which will at least entail tortious liability. If a preparatory contract is concluded, the binding nature of the contractual undertaking prevails and justifies the protection [under contract law] of the undertaking given, up to its specific performance in kind.¹⁵⁸

Again, the obligations created by the *contrats préparatoires* depend upon the type of arrangement and its proximity to the final contract. These may range from the obligation to enter the final contract to the more limited obligation of negotiating and protecting the confidentiality of secret information. In sum, all *contrats préparatoires* are binding insofar as they are contracts, but the breadth of the binding content varies according to the closeness of the preparatory agreement to the final contract.

1. *Pre-emption Agreements and Firm Offers*

Despite the numerous variations of *contrats préparatoires* acknowledged by French case law and scholarship, the 2016 reform provides regulations for only two specific types: the *pacte de préférence* (pre-emption agreement) and the

¹⁵⁶ See C. civ. art. 1112(2) (Fr.).

¹⁵⁷ There are different specific forms of arrangements that negotiating parties might enter into. See L'AVANT-CONTRAT, ACTUALITÉ DU PROCESSUS DE FORMATION DES CONTRATS (Olivier Deshayes ed., 2008); L'AVANT-CONTRAT (Jean-Marc Mousseron, Michel Guibal & Daniel Mainguy eds., 2001); FRANÇOIS COLLART-DUTILLEUL, LES CONTRATS PRÉPARATOIRES À LA VENTE D'IMMEUBLES (1988); Alfred Rieg, *La "punctuation" contribution à l'étude de la formation successive des contrats*, in ÉTUDES OFFERTES À A. JAUFFRET 593 (1974).

¹⁵⁸ Sautonie-Laguionie, *supra* note 131, at 71.

promesse unilatérale (firm offer), covered by articles 1123 and 1124 of the FCC.¹⁵⁹ The two provisions are placed immediately after the rules on pre-contractual liability and formation of contract. The *pacte de préférence* is defined as the bilateral or unilateral preparatory agreement through which a party assumes the obligation, if the party decides to sell a property, to make the first proposal to sell to the beneficiary of the pre-emption agreement.¹⁶⁰ The *promesse unilatérale* (firm offer), as previously discussed,¹⁶¹ is the obligation by which a party promises to keep its offer open for a given period, whilst the beneficiary has the option to decide whether they want to accept.¹⁶² In both cases, the FCC provides the beneficiary with remedies, such as specific performance.

Despite the FCC's narrow recognition of pre-emption agreements and firm offers, there is judicial recognition of a variety of *contrats préparatoires*.¹⁶³ The most common forms of preparatory agreements include the *contrat-cadre* (framework agreement), the *promesse synallagmatique de contrat* (agreement to agree), the *lettre d'intention* (letter of intent or memorandum of understanding), and the *accord de principe* (agreement in principle).

2. Framework Agreements and Agreements to Agree

The *contrat-cadre*, widely used in the supply of goods and distribution sectors, is the only agreement that is defined but not regulated under the FCC.¹⁶⁴ It states that a *contrat-cadre* is “an agreement by which the parties agree [upon] the general characteristics of their future contractual relations.”¹⁶⁵ The breach of a framework agreement, such as the refusal of one party to enter subsequent contracts, gives rise to contractual liability.¹⁶⁶ Furthermore, when the framework agreement defines essential terms with sufficient precision, its breach entitles the non-breaching party to specific performance.¹⁶⁷

¹⁵⁹ C. civ. art. 1123–24 (Fr.).

¹⁶⁰ See C. civ. art. 1123 (Fr.).

¹⁶¹ See Section III.B.

¹⁶² See C. civ. art. 1124 (Fr.).

¹⁶³ PORCHY-SIMON, *supra* note 132, at 72; PASCAL PUIG, *CONTRATS SPÉCIAUX* 145 (7th ed. 2017); Sefton-Green, *supra* note 131, at 59.

¹⁶⁴ C. civ. art. 1111 (Fr.).

¹⁶⁵ *Id.* Puig and Giliker provide an explanation of the rules applicable to framework agreements under French law. See PUIG, *supra* note 155, at 165–79; GILIKER, *supra* note 153, at 21–27.

¹⁶⁶ PUIG, *supra* note 163, at 176–77.

¹⁶⁷ *Id.*

Of a different nature is the *promesse synallagmatique de contrat* (agreement to agree), which is a preparatory contract under which parties agree to enter a contract on a future date.¹⁶⁸ The *promesse synallagmatique de contrat* is mostly used in transactions involving the sale of immovable property.¹⁶⁹ A buyer and seller may conclude a sale of real estate orally or in writing since real estate contracts are simple contracts under French law, not requiring a written form.¹⁷⁰ The parties are assumed to commit themselves to concluding a further contract before a notary or after the buyer's funds clear.¹⁷¹ The effect of a *promesse synallagmatique de contrat* depends on the interpretation of the will of the parties. If the parties consider notarization or the assurance of funding as essential for the conclusion of the sale contract, the contract will be qualified as a conditional sale and will cease to be effective if the conditions are not met. The frustrated party, however, may be entitled to damages for pre-contractual liability. If, by contrast, the parties did not consider the subsequent acts as essential, the original contract is considered valid and fully effective. The key point, therefore, lies in the interpretation of the parties' understanding.¹⁷²

3. Letters of Intent and Agreements in Principle

The *lettres d'intention* and the *accords de principe* are preparatory agreements considered far removed from the final contract.¹⁷³ The *lettre d'intention* is commonly understood as the parties' affirmation of their willingness to negotiate: it states the terms upon which they agree and frame the negotiation process for the terms yet to be agreed upon.¹⁷⁴ In this case too, the key point is whether the parties had agreed on all the essential terms of the future contract.¹⁷⁵ If they have agreed, the *lettre d'intention* can be deemed as equivalent to the final contract—entitling the non-breaching party to contractual damages and specific performance.¹⁷⁶ If there is no agreement on essential

¹⁶⁸ PORCHY-SIMON, *supra* note 132, at 72; JEAN-LUC AUBERT & FRANÇOIS COLLART DUTILLEUL, *LE CONTRAT. DROIT DES OBLIGATIONS* 70 (5th ed. 2017).

¹⁶⁹ PORCHY-SIMON, *supra* note 132, at 72; AUBERT & DUTILLEUL, *supra* note 168, at 70.

¹⁷⁰ ZWEIGERT & KÖTZ, *supra* note 9, at 369.

¹⁷¹ PORCHY-SIMON, *supra* note 132, at 72; AUBERT & DUTILLEUL, *supra* note 168, at 70.

¹⁷² *Id.*

¹⁷³ PUIG, *supra* note 155, at 147–49; GILIKER, *supra* note 153, at 52–53. The *lettre d'intention* should not be confused with the *lettre d'intention* (comfort letter) regulated by Article 2322 of the French Civil Code, which is “the commitment to do or not to do, the purpose of which is to support a debtor in the performance of his obligation towards his creditor.” C. civ. art. 2322 (authors' translation).

¹⁷⁴ PUIG, *supra* note 155, at 147–49; GILIKER, *supra* note 153, at 52–53.

¹⁷⁵ PUIG, *supra* note 155, at 148–49; GILIKER, *supra* note 153, at 52–53.

¹⁷⁶ PUIG, *supra* note 155, at 147–49; GILIKER, *supra* note 153, at 52–53.

terms, the *lettre d'intention* may still obligate the parties to pursue negotiations according to its terms—thus entitling the non-breaching party, in case of breach, to contractual damages but not specific performance.¹⁷⁷

In an *accord de principe* (agreement in principle or *contrat de négociation*), the parties agree to bind themselves to negotiating contractual terms, but the conclusion of the contract remains uncertain.¹⁷⁸ *Accords de principe* are often combined with *conventions de confidentialité* (confidentiality agreements), through which the parties agree that certain information exchanged during negotiations will remain confidential.¹⁷⁹ In sum, *accords de principe* give rise to an obligation of negotiating a contract. Accordingly, the breach of an *accord de principe* might give rise to contractual liability for breach of the duty to negotiate or the duty to protect confidentiality.¹⁸⁰

C. A Matter of Interpretation

The enforceability of *lettres d'intention* and *accords de principe*, as well as the other discussed preparatory agreements, is a matter of judicial interpretation of the will of the parties.¹⁸¹ If a French court concludes that the parties agreed on all essential elements (terms), the preparatory agreement is a fully binding contract.¹⁸² If the court deems that an agreement on all essential elements was not reached, the preparatory arrangement may qualify as binding on the parties as to their obligations to negotiate in good faith.¹⁸³ The breach of the duty of good faith entitles the frustrated party to claim damages in contract rather than in tort.¹⁸⁴ Yet, since the conclusion of the contract is uncertain in these cases, the breaching party will be limited to a claim for reliance damages as provided by Article 1112 of the FCC.¹⁸⁵

The assessment of the will of the parties is thought to be a question of fact, to be determined at the discretion of the court.¹⁸⁶ Courts will examine the parties'

¹⁷⁷ PUIG, *supra* note 155, at 147–49; GILIKER, *supra* note 153, at 52–53.

¹⁷⁸ PUIG, *supra* note 155, at 147–49; GILIKER, *supra* note 153, at 52–53.

¹⁷⁹ AUBERT & DUTILLEUL, *supra* note 168, at 68–69; PUIG, *supra* note 155, at 149; GILIKER, *supra* note 153, at 42–45.

¹⁸⁰ *Id.*

¹⁸¹ PUIG, *supra* note 155, at 145–49.

¹⁸² *Id.*

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ GILIKER, *supra* note 153, at 18–19.

behavior objectively but will also give relevance to what the parties considered essential for the conclusion of the contract. The wording employed by the parties—such as words of condition or the specification that the arrangement is meant to be binding—is important but not decisive.¹⁸⁷

In *Créations Nelson v. Camaieu International*, two companies signed a settlement agreement (*accord transactionnel*), according to which, *Camaieu* undertook the obligation not to copy the products commercialized by *Créations*, with the qualification that such an obligation was a “purely a moral obligation whose violation will not be considered a breach of the present agreement.”¹⁸⁸ A few weeks after the execution of the agreement, *Créations* accused *Camaieu* of trademark infringement and brought suit for breach of the unilateral obligation not to copy its products. The Court of Cassation held that the settlement agreement contained a unilateral and binding obligation on *Camaieu* because “by agreeing, even if only morally, not to copy the products of *Créations*, it expressed an unequivocal and deliberate will to be bound.”¹⁸⁹ This case shows that French courts accord enforceability to agreements that the parties themselves qualified as non-binding.¹⁹⁰ The underlying rationale of this tendency is that “anyone is free to decide whether to enter or not into a contract; but nobody can decide to enter into a contract and escape the legal consequences of this decision.”¹⁹¹

In practice, French courts address the issue of whether a preparatory agreement is binding through a two-step process. First, the court determines whether the preparatory agreement contains all the necessary elements for bilateral or unilateral contractual obligations to arise. If not, the courts must determine whether the parties assumed pre-contractual obligations and assess whether one party breached its obligation or the corresponding extra-contractual obligation to negotiate in good faith. In negotiations between merchants, liability will be affirmed only if the court determines there has been misbehaviour of the breaching party and justified reliance by the other party. But whenever negotiations advance far enough (duration of negotiations; close to final agreement) and a party withdraws, the courts view that as a breach of the

¹⁸⁷ AUBERT & DUTILLEUL, *supra* note 168, at 67–68; PUIG, *supra* note 155, at 149.

¹⁸⁸ Cass.com., Jan. 23, 2007, 05-13.189, Bull. civ. IV, No. 12, 2007, p. 13 (Fr.) (authors’ translation).

¹⁸⁹ *Id.* (authors’ translation).

¹⁹⁰ AUBERT & DUTILLEUL, *supra* note 168, at 67–68; PUIG, *supra* note 155, at 148–49; James Gordley, *Comparisons*, in *THE ENFORCEABILITY OF PROMISES IN EUROPEAN CONTRACT LAW* 337, 353–54 (James Gordley ed. 2001).

¹⁹¹ AUBERT & DUTILLEUL, *supra* note 168, at 67.

relationship of trust and confidence and impose liability.¹⁹² This approach is illustrated in the two following decisions.

In *X v. Continentale d'entreprises*,¹⁹³ the parties partook in a lengthy negotiation for the purchase by *X* of shares of a chemical company owned by *Continentale d'entreprises* before *X* and the chemical company commenced a joint project. At the end of the negotiations, the parties signed a *lettre-accord* (memorandum of agreement) in which they defined the quantity and the price of the shares but also declared that the parties still had to agree on the seller's warranty relating to the debts of the company being sold. Soon thereafter, the chemical company abandoned the project. *Continentale d'entreprises* subsequently sold the company's shares to a third party. *X* sued *Continentale d'entreprises* for breach of the *lettre-accord*, characterizing it as a binding contract of sale. The Court of Cassation held the *lettre-accord* was not equivalent to a contract of sale since there was no agreement on an essential term (seller's liability for debt). In the words of the Court, the *lettre-accord* was "an agreement in principle obliging the parties to carry out negotiations in good faith."¹⁹⁴ Given that *Continentale d'entreprises* had not violated that agreement, no liability could be established against it.¹⁹⁵

In a similar and often quoted case, *Manoukian v. X et Les Complices*,¹⁹⁶ the Court went in the opposite direction. It concluded that the preparatory arrangement entered by the parties was not binding either as a final contract or as an agreement to negotiate in good faith. Nonetheless, the Court held the defendant liable for violation of the extra-contractual duty to negotiate in good faith. The parties engaged in negotiations for the purchase of shares of another company owned by one of the parties. A *projet d'accord* (draft agreement) subject to conditions was entered into and subsequently revised on two occasions. Soon thereafter, *X* transferred the shares to a third party. The Court of Cassation determined that the parties viewed the agreement as conditional and not binding. However, the Court held that, given the advanced stage of the negotiations and *X*'s silence on the existence of parallel negotiations, a party's withdrawal from the negotiations breached the duty of good faith negotiations

¹⁹² ZULOAGA, *supra* note 153, at 130, 90. *See also* Cass. com., Jan. 7, 1997, 94-21.561 (Fr.); Cass. com., Apr. 22, 1997, 94-18.953 (Fr.).

¹⁹³ Cass. 1e civ., May 29, 2013, 12-16.563 (Fr.).

¹⁹⁴ *Id.* (authors' translation).

¹⁹⁵ *Id.*

¹⁹⁶ *Manoukian v. X*, *supra* note 153.

and was liable for extra-contractual damages for *rupture abusive des pourparlers* (abrupt termination).¹⁹⁷

IV. ENFORCEABILITY AND LIABILITY OF PRELIMINARY AGREEMENTS IN CHINESE LAW

Chinese law recognizes that some preliminary agreements are enforceable, requiring the parties to negotiate in good faith, as well as the existence of a minority view that the parties may be required to enter into a final contract. Chinese law also distinguishes between a general duty of good faith negotiations and good faith negotiations stemming from a preliminary agreement.

A. *Preliminary Agreement in China: An Overview*

Before 2012, there were no specific rules in China governing the enforceability of preliminary agreements.¹⁹⁸ Instead, the Chinese courts applied general contract law rules by analogy.¹⁹⁹ In 2012, the Chinese Supreme People's Court promulgated the *Judicial Interpretation on Sales*,²⁰⁰ which provides in Article 2 a specific rule on preliminary agreements:

If a party signs a preliminary agreement such as letter of subscription, letter of order, letter of reservation, letter of intent or memorandum, which states that a sales contract will be entered into within a certain

¹⁹⁷ *Id.*

¹⁹⁸ Preliminary agreements are discussed in Articles 4 and 5 of Interpretation on Issues concerning the Application of Law to the Hearing of Cases Involving Disputes over Contracts for the Sale and Purchase of Commodity House (2020 Amendment), Judicial Interpretation No. 17 [2020] (promulgated by Sup. People's Ct., Dec. 29, 2020, effective Jan. 1, 2021) [hereinafter *Judicial Interpretation on Commodity House*], https://www.pkulaw.com/en_law/5f40f2e267eb9323bdfb.html (China). Article 4 states that, unless a party acts badly, failure to enter a final contract requires only that the seller refund the earnest money, while Article 5 states that where a preliminary agreement includes the principal terms of a contract for sale, as provided in Article 16 of the Administrative Measures for the Sale of Commodity Houses and the seller has accepted money for the purchase, the agreement shall be considered a final contract. *Id.*

¹⁹⁹ See e.g., *Zhuhai Wanli Rd. Enter. Co. v. Zhuhai Chentai Real Estate Dev. Co.*, 广东珠海中级人民法院(2008)珠中法民一终字第 104 号 [2008 ZZFMYYZZ No. 104] (Guangdong Zhuhai Intermediate People's Ct. Nov. 20, 2008) (China) (applying Contract Law of the People's Republic of China [CCL] Article 110 for denying the non-breaching party's claim for specific performance of a preliminary agreement); *Beijing Uconia Decoration Eng'g Co. v. Beijing Henrydai Furnishing Co.*, 北京第二中级人民法院(2007)二中民终字 01756 号 [2007 EZMZZ No. 01756] (Beijing Second Intermediate People's Ct. Mar. 19, 2007) (China) (applying CCL Article 113 to award damages for breach of a preliminary agreement).

²⁰⁰ Interpretation on Issues Concerning the Application of Law in the Trial of Cases of Disputes over Sales Contracts, Judicial Interpretation No. 8 [2012] (promulgated by Sup. People's Ct., May 10, 2012, effective July 1, 2012) [hereinafter *Judicial Interpretation on Sales*], https://www.pkulaw.com/en_law/deb83c1e931b15c1bdfb.html (China).

period in the future, and a party fails to perform the obligation to enter into the sales contract while the other party requests it to undertake the liability for the breach of the preliminary agreement, or requests to terminate the preliminary agreement and claims damages, the people's courts shall uphold such a request and claim.²⁰¹

The above provision was adopted in the *Chinese Civil Code* (CCC) of 2021 with minor changes. Under the CCC, a preliminary agreement is a legally binding agreement in which the parties agree to conclude a final contract in the future.²⁰² Preliminary agreements are found in all sectors of the economy including commodity house purchases,²⁰³ leases,²⁰⁴ strategic cooperation,²⁰⁵ and so forth.²⁰⁶ The enforceability of such agreements is recognized in CCC Article 495.²⁰⁷

A letter of subscription, letter of order, letter of reservation, or the like, in which the parties agree to conclude a contract within a certain period of time in the future, constitutes a preliminary agreement. Where one of the parties fails to perform the obligation to conclude a contract agreed to in the preliminary agreement, the other party may request such party to undertake the liability for breach of the preliminary agreement.²⁰⁸

The preliminary agreement provisions of the CCC are found in Part I (General Provisions) in Book III (Contracts), which indicates that the provisions regarding enforceability of preliminary agreements not only apply to sales

²⁰¹ *Id.* art. 2.

²⁰² CCC, *supra* note 11, art. 495; *see also* Chengdu Xunjie Commc'ns Chain Co. v. Sichuan Shudu Indus. Co., 最高人民法院(2013)民提字第 90 号 [2013 MTZ No. 90] (Sup. People's Ct. Nov. 14, 2013) (China) (whether a contract is a final or a preliminary agreement depends on the parties' intention, that is, whether the parties intend to enter into a final contract in the future).

²⁰³ *See* Longda Real Est. Co. v. Zhang Mingjie, 河南高级人民法院(2020)豫民申 2776 号 [2020 YMS No. 2776] (Henan High People's Ct. June 10, 2020) (China).

²⁰⁴ *See* Shenzhen Fangu Dadi Inc. v. Shenzhen Baohuasen Indus. Co., 最高人民法院(2020)最高法民申 2164 号 [2020 ZGFMS No. 2164] (Sup. People's Ct. June 30, 2020) (China).

²⁰⁵ *See* Beijing Zhongjing Logistics Co. v. Xinjiang Zhongyuan Guotie Logistics Co., 最高人民法院(2014)民申字第 709 号 [2014 MSZ No. 709] (Sup. People's Ct. 2014) (China).

²⁰⁶ *See* Zhang Yuqi v. Foshan Shunde Yinjing Real Est. Co., 最高人民法院(2016)最高法民申 200 号 [2016 ZGFMS No. 200] (Sup. People's Ct. Mar. 31, 2016) (China); Shaoguan Nanfeng Prop. Mgmt. Co. v. First Prop. Owners Comm. of Fu'ange, Qurenyuan, Shaoguan, 广东韶关中级人民法院(2021)粤 02 民终 1663 号 [2021 Y02MZ No. 1663] (Guangdong Shaoguan Intermediate People's Court Sept. 26, 2021) (China).

²⁰⁷ CCC, *supra* note 11, art. 495.

²⁰⁸ *Id.* art. 495.

contracts but also to other types of transactions.²⁰⁹ CCC Article 495 deletes the phrases “letter of intent” and “memorandum” previously found in Article 2 of the *Judicial Interpretation on Sales*.²¹⁰ Thus, Article 495 only applies to the types of letters of intent or memorandums that constitute enforceable preliminary agreements.²¹¹ In determining whether a letter of intent, memorandum, or similar instrument constitutes a legally binding preliminary agreement, due consideration is given to all relevant circumstances, including the content of the document, the process of negotiation, and the intent of the parties. It is also important to consider whether the parties agreed to the payment of earnest money and the legal consequences for breaching the agreement.²¹²

B. *Enforceability of Preliminary Agreements*

Once a preliminary agreement is concluded, the parties must perform their obligations in accordance with the agreement. The primary obligation is to conclude a final and complete contract.²¹³ Despite that obligation, there is a debate over whether the parties are obliged to negotiate in good faith²¹⁴ versus being bound to consummate a final contract.²¹⁵ The dominant view supported

²⁰⁹ COMMENTARY ON CHINESE CIVIL CODE: CONTRACTS 78 (Huang Wei ed. 2020). However, due to Article 174 of the CCC, preliminary agreement discussed in Article 2 of the Judicial Interpretation on Sales may be applied by analogy to other types of bilateral contracts. CCC, *supra* note 11, art. 174.

²¹⁰ UNDERSTANDING AND APPLICATION OF CHINESE CIVIL CODE: CONTRACTS 236–37 (Supreme People’s Court ed., Vol. 1 2020); GUANGXIN ZHU, STUDY ON GENERAL PRINCIPLES OF CONTRACT LAW 31 (2018); Chengwei Liu, *A Study of Analytic Hierarchy on Preliminary Agreement*, 6 LEGAL F. 33, 35 (2013); *see also* Aohua Asset Management Co., Ltd. v. Yangpu Economic Development Zone Management Committee, 最高人民法院(2014)民申字第 263 号 [2014 MSZ No. 263] (Sup. People’s Ct.) (China) [hereinafter UNDERSTANDING AND APPLICATION OF CCC](finding that a letter of intent to invest is not a preliminary agreement due to its lack of material terms and intent to be legally bound).

²¹¹ *See* Liu, *supra* note 210, at 35. However, it does not mean that the parties to the unenforceable preliminary agreement may act in bad faith. Otherwise, the injured party may still claim compensation for its out-of-pocket losses based on article 500 of the CCC (pre-contractual liability). *See* UNDERSTANDING AND APPLICATION OF CCC, *supra* note 210, at 237; CCC, *supra* note 11, art. 500.

²¹² Interpretation on Issues Concerning Contracts of the Chinese Civil Code (I) (promulgated by the Supreme People’s Court, draft version on Sept. 17, 2021) art. 9 [hereinafter Draft Judicial Interpretation on Contracts].

²¹³ In practice, the preliminary agreements may include other obligations relating to confidentiality, disclosure, and exclusivity.

²¹⁴ *See* Lihang Geng, *Enforceability & Remedies of the Preliminary Agreements: Empirical Analysis & idealistic Solution*, 5 CHINESE J. L. 27, 32 (2016).

²¹⁵ *See* Shandong Lingzhong Mech. & Elec. Equip. Co. v. PLA No. 3304 Factory, 最高人民法院(2013)民申字第 1715 号 [2013 MSZ No. 1715] (Sup. People’s Ct. 2013) (China) (holding that the parties to the preliminary agreement undertake a compulsory obligation to conclude the final contract).

by the Supreme People's Court is that the parties are only obligated "to negotiate in good faith."²¹⁶

The mainstream view recognizes acceptance under Chinese law of a general duty to bargain in good faith.²¹⁷ However, the general duty to bargain in good faith is narrowly construed to exclude certain acts of bad faith, such as engaging in negotiations with malicious intention, including concealing material facts, giving false information, failing to complete the procedures of applying for necessary approvals or registrations, and disclosure or use of trade secrets or confidential information obtained during the negotiations.²¹⁸ The parties' good faith obligation in preliminary agreements is broadly construed to include the duty to make reasonable or best efforts to conclude a final contract.²¹⁹ Under this duty, the parties are prohibited from changing terms previously agreed upon and insisting on unfair terms or terms contrary to trade customs. Negotiations with competing bidders are also an act of bad faith whenever exclusivity is expected.²²⁰ However, the failure to conclude a final contract itself is not a sufficient indicator of bad faith.²²¹

In *Dai Xuefei v. Huaxin International Urban Development Co., Ltd.*, the court considered the enforceability of a preliminary agreement relating to the purchase of a commodity house.²²² The court held that the significance of a

²¹⁶ See Geng, *supra* note 214, at 32, 47; ZHU, *supra* note 210, at 31; see also JUDICIAL INTERPRETATION ON SALES CONTRACT: UNDERSTANDING & APPLICATION 58 (Second Division of the Sup. People's Ct. ed. 2016) (parties to the preliminary agreement shall undertake the obligation to negotiate in good faith to conclude the final contract. "Otherwise, the breaching party shall undertake the liability for breach of the preliminary agreement, unless the breach is due to any reason not attributable to both parties") (emphasis added).

²¹⁷ CCC, *supra* note 11, art. 500.

²¹⁸ CCC, *supra* note 11, arts. 500, 501; Interpretation on Certain Issues Concerning the Application of the Contract Law of the People's Republic of China (II) No. 5 [2009] (promulgated by the Sup. People's Ct., repealed in 2020) art. 8.

²¹⁹ Liming Wang, *Several Issues on Preliminary Agreement: Commentary on Article 2 of the Judicial Interpretation on Sales*, 1 STUD. L. & BUS. 54, 60 (2014).

²²⁰ Liu, *supra* note 210, at 37–38; see also, Jiang Fei v. Weihai Hengxin Real Est. Co., 山东威海中级人民法院(2021)鲁10民终2163号 [2021 L10MZ No. 2163] (Shandong Weihai Intermediate People's Ct. Sep. 11, 2021) (finding that the breaching party requested a reduction of the price agreed to in the preliminary agreement).

²²¹ See Hubei Lianrui Real Est. Co. v. Zhang Yunfang, 湖北鄂州中级人民法院(2021)鄂07民终561号 [2021 E07MZ No. 561] (Hubei Ezhou Intermediate People's Ct. Jul. 20, 2021) (China); Xinghua Zhaotai Metal Materials Co. v. Yang Zhaoshun, 江苏高级人民法院(2016)苏民终178号 [2016 SMZ No. 178] (Jiangsu High People's Ct. Oct. 26, 2016) (China) (holding that refusal to conclude a final contract does always constitute a breach of the preliminary agreement).

²²² *Dai Xuefei v. Huaxin Int'l Urban Dev. Co.*, 2006 最高人民法院公报案例第 08 期 [2006 Sup. People's Ct. Gaz. 8] (Jiangsu Suzhou Intermediate People's Ct. May 18, 2005) (China) (explaining a disagreement on the following standard clause in the final contract: "[s]ample house is for reference only, the right to interpret the contract shall reside in the seller") (authors' translation).

preliminary agreement is to ensure negotiations continue under the principles of fairness and good faith, with the goal of making a final contract. In negotiations subsequent to a preliminary agreement, failure to comply with those principles is grounds for liability for breach. Denying a previous agreement to settled terms, setting forth an unreasonable condition, or refusal to negotiate further are considered breaches of a preliminary agreement.²²³ However, if, after fair negotiations in good faith bargaining the parties fail to reach a consensus, neither party is liable for breach.

C. *Liability for Breach of Preliminary Agreement*

This section reviews two views for the basis for liability in a breach of a preliminary agreement: fault-based and strict liability.

1. *Fault-based Liability and Strict Liability*

The rationale for granting damages is different between the obligation to negotiate in good faith and the duty to reach a final contract in a preliminary agreement. In the first case, the breaching party's liability for failing to conclude the final contract is fault-based. The law recognizes a presumption of fault by allocating the burden of proving reasonableness to the breaching party.²²⁴ On the other hand, the breaching party's failure of the duty to conclude a final contract results in strict liability.²²⁵

Chinese courts support the obligation to negotiate in good faith.²²⁶ As a result, the courts prefer fault-based liability over strict liability, as shown in *Dai*

²²³ *Id.*; see also Zhong Chongqing v. Shanghai Jinxuandadi Real Est. Dev. Co., 2008 年最高人民法院公报案例第 04 期 [2008 Sup. People's Ct. Gaz. 4] (Shanghai Second Intermediate People's Ct. Oct. 19, 2007) (China) (demonstrating a party refusing to negotiate and denying the price provided in the preliminary agreement).

²²⁴ Geng, *supra* note 214, at 33; Liu Juan v. Xu Yinyin, 陕西渭南中级人民法院(2020)陕 05 民终 2335 号 [S05MZ No. 2335] (Shaanxi Weinan Intermediate People's Ct. Nov. 30, 2020) (China) (the breaching party failed to prove that the failure to conclude the final contract was due to the reason not attributable to itself); see also Judicial Interpretation on Commodity House, *supra* note 198, art. 4 (“[w]here a seller receives an earnest money from the buyer by way of subscription, order or reservation, etc., as a guarantee for the conclusion of a contract for sale and purchase of the relevant commodity house, if one of the parties for any reason is unable to conclude the contract for sale and purchase of the commodity house, the rules on earnest money shall apply; if for any reason not attributable to either party the contract for sale and purchase of the commodity house in question cannot be concluded, the seller shall refund the earnest money to the buyer”) (authors' translation, emphasis added).

²²⁵ Geng, *supra* note 214, at 33; ZHU, *supra* note 210, at 697.

²²⁶ Geng, *supra* note 214, at 33; UNDERSTANDING AND APPLICATION OF CCC, *supra* note 210, at 58.

*Xuefei v. Huaxin International*²²⁷ and *Zhanjiang Haixin Meikai Investment Co., Ltd. v. Xu Yanni*.²²⁸ In the latter case, the court held that since the parties failed to reach an agreement on key terms and conditions, the buyer did not commit a breach for failing to conclude a final contract. The court reasoned that the parties undertook an obligation to negotiate in good faith. If, after a good faith negotiation, a final contract is not concluded, the parties are free of any liability based on the principle of good faith, including in cases where a party incurs substantial costs in reliance on concluding a contract.²²⁹

2. Remedies for Breach of Preliminary Agreement

This section reviews the availability of specific performance and the types of recoverable damages available for breaches of preliminary agreements.²³⁰ The specific performance remedy consists of a court order to compel the breaching party to perform based on the terms of the preliminary agreement.²³¹ Chinese law regards damages and specific performance as ordinary and equal remedies.²³² The claimant chooses whether to seek specific performance or to collect damages. However, in practice, awards of specific performance are less frequent than is commonly assumed. Chinese courts commonly reject claims for specific performance due to a breach of a preliminary agreement.²³³

²²⁷ Dai Xuefei v. Huaxin Int'l Urban Dev. Co., *supra* note 222.

²²⁸ *Zhanjiang Haixin Meikai Inv. Co. v. Xu Yanni*, 广东湛江中级人民法院 (2021)粤 08 民终 3140 号 [2021 Y08MZ No. 3140] (Guangdong Zhanjiang Intermediate People's Ct. Aug. 30, 2021) (China).

²²⁹ *Id.*; *see also* Li Jiayuan v. Chongqing Baoxiang Real Est. Dev. Co., 重庆高级人民法院(2020)渝民终 37 号 [YMZ No. 37] (Chongqing High People's Ct. Oct. 29, 2020) (China); Wang Kanghui v. Qingdao Zhonglei Real Est. Dev. Co., 山东高级人民法院(2020)鲁民申 8588 号 [2020 LMS No. 8588] (Shandong High People's Ct. Nov. 30, 2020) (China).

²³⁰ CCC, *supra* note 11, art. 495; *see also* Judicial Interpretation on Sales, *supra* note 200, art. 2.

²³¹ CCC, *supra* note 11, arts. 579, 580 (specific performance of monetary obligation and specific performance of non-monetary obligation, respectively).

²³² CCC, *supra* note 11, art. 577; Lei Chen, *Damages and Specific Performance in Chinese Contract Law*, in *CHINESE CONTRACT LAW: CIVIL & COMMON LAW PERSPECTIVES* 401–02 (Larry A. DiMatteo & Lei Chen eds., 2018).

²³³ An empirical study shows that in China damages are often favored over specific performance; judges often exercise their power of persuasion to encourage the non-breaching party to accept damages. *See* Lei Chen & Larry A. DiMatteo, *Inefficiency of Specific Performance as a Contractual Remedy in Chinese Courts: An Empirical and Normative Analysis*, 40 *NW. J. INT'L L. & BUS.* 275, 302–03, 331 (2020); *see, e.g.*, Zhang Yuqi v. Foshan Shunde Yinjing Real Estate Co., Ltd., 最高人民法院(2016)最高法民申 200 号 [2016 ZGFMS No. 200] (Sup. People's Ct. Mar. 31, 2016) (China).

The reasons given for not granting specific performance of preliminary agreements is that it is contrary to the principle of freedom of contract²³⁴ when the agreement is missing important terms,²³⁵ making the remedy “impossible de jure”²³⁶ and “not suitable for a compulsory performance.”²³⁷ In *Longda Real Estate Co., Ltd., Hongfa Trade Group v. Zhang Mingjie*, the Court held that “the parties are entitled to enter into a [final] contract of their own free will, and no person or unit may interfere unlawfully. If the breaching party does not cooperate, the court may not violate the principle of free will by forcing it to conclude the contract and therefore, claims for specific performance of the preliminary agreement . . . lack legal base.”²³⁸

The non-breaching party may claim damages by proving actual losses caused by the breaching party’s failure to conclude the contract.²³⁹ Article 495 of the CCC authorizes the non-breaching party to request that the breaching party “undertake liability for breach of the preliminary agreement.”²⁴⁰ Other types of pre-contractual liability such as *culpa en contrahendo* or bad faith negotiations, is provided for in Article 500 of the CCC.²⁴¹ However, the non-breaching party

²³⁴ HUIXING LIANG, LECTURE NOTES ON GENERAL PRINCIPLES OF CONTRACT LAW 99 (2021); CCC, *supra* note 11, art. 5; Yang Jieli v. Guangdong Yongyi Grp. Inc., 广东中山中级人民法院(2020)粤 20 民终 5067 号 [2020 Y20MZ No. 5067] (Guangdong Zhongshan Intermediate People’s Ct. Nov. 20, 2020) (China).

²³⁵ See Shen Wei, *Liability Prior to Contract Formation in Chinese Contract Law*, in CHINESE CONTRACT LAW: CIVIL & COMMON LAW PERSPECTIVES 147 (Larry A. DiMatteo & Lei Chen eds., 2018); see also Zhang Yuqi v. Foshan Shunde Yinjing Real Est. Co., 最高人民法院(2016)最高法民申 200 号 [2016 ZGFMS No. 200] (Sup. People’s Ct. Mar. 31, 2016) (China).

²³⁶ CCC, *supra* note 11, art. 580(1); LIANG, *supra* note 234, 99–100.

²³⁷ CCC, *supra* note 11, art. 580(2) (authors’ translation); Ma’anshan Dongrong Real Est. Co. v. Wang Leilei, 安徽马鞍山中级人民法院(2021)皖 05 民终 1740 号 [2021 W05MZ No. 1740] (Anhui Ma’anshan Intermediate People’s Court Oct. 29, 2021) (China); Wang Dian v. Anhui Jintaiyang Real Est. Inv. Co., 安徽滁州中级人民法院(2021)皖 11 民终 1269 号 [2021 W11MZ No. 1269] (Anhui Chuzhou Intermediate People’s Ct. May 6, 2021) (China). *But see* SHIYUAN HAN, THE LAW OF CONTRACT 93–94 (4th ed. 2018); 1 LIMING WANG, CONTRACT LAW 18 (2d ed. 2021); YONGJUN LI, CONTRACT LAW 239 (5th ed. 2020) (all arguing that the specific performance of the preliminary agreement is a suitable remedy).

²³⁸ *Longda Real Est. Co. v. Zhang Mingjie*, 河南高级人民法院(2020)豫民申 2776 号 [2020 YMS No. 2776] (Henan High People’s Ct. Jun. 10, 2020) (China) (authors’ translation); see also *Shenzhen Fangu Dadi Inc. v. Shenzhen Baohuasen Indus. Co.*, 最高人民法院(2020)最高法民申 2164 号 [2020 ZGFMS No. 2164] (Sup. People’s Ct. May 30, 2020) (China); *Luoyang Kaiyang Real Est. Dev. Co. v. Zhang Wujuan*, 河南洛阳中级人民法院(2021)豫 03 民终 755 号 [2021 Y03MZ No. 755] (Henan Luoyang Intermediate People’s Ct. Mar. 1, 2021) (China); *Zhang Yuqi v. Foshan Shunde Yinjing Real Est. Co.*, 最高人民法院(2016)最高法民申 200 号 [2016 ZGFMS No. 200] (Sup. People’s Ct. Mar. 31, 2016) (China) (all denying claims for specific performance of preliminary agreements).

²³⁹ See, e.g., *Hubei Lianrui Real Est. Co. v. Zhang Yunfang*, *supra* note 221; *Li Jiayuan v. Chongqing Baoxiang Real Est. Dev. Co.*, 重庆高级人民法院(2020)渝民终 37 号 [2020 YMZ No. 37] (Chongqing High People’s Ct. Oct. 29, 2020) (China) (both rejecting claims for the claimant’s failure to prove actual losses).

²⁴⁰ CCC, *supra* note 11, art. 584 (authors’ translation).

²⁴¹ See *id.* art. 500.

is precluded from claiming expectancy damages (loss profits) if the final contract has not been concluded.²⁴² Thus, damages vary based upon whether negotiations include the use of a preliminary agreement and whether the court concludes that a final contract had been reached.²⁴³

Unfortunately, Article 495 of the CCC provides no guidance as to whether the non-breaching party should be awarded expectation damages (lost profits) or reliance damages (out-of-pocket expenses). Most Chinese courts favor granting reliance damages for breach of a preliminary agreement.²⁴⁴ However, reliance damages are more broadly construed in Chinese courts than those in the common law countries. The non-breaching party may claim damages for opportunities lost, which could result in compensation approximating expectation damages.²⁴⁵ In determining damages related to loss of opportunities,²⁴⁶ the courts consider a number of factors including: degree of reliance, degree of certainty that a final contract would be concluded, damages

²⁴² See *Shenzhen Fangu Dadi Inc. v. Shenzhen Baohuasen Indus. Co.*, 最高人民法院(2020)最高法民申2164号 [2020 ZGFMS No. 2164] (Sup. People's Ct. Mar. 30, 2020) (China).

²⁴³ See HAN, *supra* note 237, at 96; WANG, *supra* note 237, at 18; COMMENTARY ON CHINESE CIVIL CODE, *supra* note 209, at 81; see also *Shi Jian v. Zhengzhou Guorui Real Est. Dev.*, 河南郑州中级人民法院(2021)豫01民终9948号 [2021 Y01MZ No. 9948] (Henan Zhengzhou Intermediate People's Court Aug. 27, 2021) (China); *Weifang Mingxuan Real Est. Co., Lechang Branch v. Weifang Mingxuan Real Est. Co.*, 山东潍坊中级人民法院(2021)鲁07民终5052号 [2021 L07MZ No. 5052] (Shandong Weifang Intermediate People's Ct. Jul. 14, 2021) (China) (all denying damages for the loss of gains obtainable under the final contract).

²⁴⁴ UNDERSTANDING AND APPLICATION OF CCC, *supra* note 210, at 61–62; Draft Judicial Interpretation on Contracts, *supra* note 212, art. 11; see also *Outpatient Dep't Wuhan Hongren Traditional Chinese Med. Hosp. v. Wuhan Xintaiyang Tech. Co.*, 湖北武汉中级人民法院(2020)鄂01民终8070号 [2020 E01MZ No. 8070] (Hubei Wuhan Intermediate People's Ct. Nov. 10, 2020) (China). *But see* *Wenzhou Golden Lion Real Est. Dev. v. Yangfushan Tucun Econ. Coop., Binjiang St., Lucheng Dist., Wenzhou*, 浙江温州中级人民法院(2020)浙03民终5901号 [2020 Z03MZ No. 5901] (Zhejiang Wenzhou Intermediate People's Ct. Feb. 22, 2020) (China) (awarding expectation interests, but holding that the non-breaching party must mitigate its losses).

²⁴⁵ See Liu, *supra* note 210, at 38; *Zhong Chongqing v. Shanghai Jinxuandadi Real Est. Dev. Co.*, 2008年最高人民法院公报案例第04期 [2008 Sup. People's Ct. Gaz. 4] (Shanghai Second Intermediate People's Ct. Oct. 19, 2007) (China); *Zhongshan Changjiang Zhaoye Real Est. Dev. Co. v. Wu Ganghui*, 广东中山中级人民法院(2020)粤20民终5586号 [2020 Y20MZ No. 5586] (Guangdong Zhongshan Intermediate People's Ct. Nov. 18, 2020) (China) (both awarding reliance losses, including loss of opportunity damages). *But see* *Hua Zhang, Remedies for the Breach of Preliminary Agreement*, 2 J.L. APPLICATION 66, 76 (2019) (arguing that no losses of opportunities shall be awarded, otherwise there would be no substantial difference between the expectation interests and reliance interests); *Cao Canru v. Shanghai Laiyinsi Real Est. Co.*, 上海第二中级人民法院(2010)沪二中民二(民)终字第609号 [2010 HEZMEZZ No. 609] (Shanghai Second Intermediate People's Ct. Oct. 15, 2010) (China) (denying compensation for the losses of opportunities due to lack of certainty).

²⁴⁶ Loss of opportunities refers to the loss of the non-breaching party ability to take advantage of other contractual opportunities due to the preliminary agreement. See Liu, *supra* note 210, at 38.

foreseeable at the conclusion of the agreement, probability of entering into a substitute contract, and the relative fault of the parties.²⁴⁷

A preliminary agreement may require one party to make an earnest money deposit to show its good faith intent to conclude a final contract.²⁴⁸ If a party fails to negotiate in good faith, then it is not entitled to a refund of the earnest money. If the breaching party is the holder of the earnest money, then it is required to refund twice the amount of the earnest money.²⁴⁹ This use of deposits is found in the doctrine of *arrhes* found in French law.²⁵⁰ Where the earnest money is not sufficient to compensate for the losses incurred by the non-breaching party, additional damages may be claimed.²⁵¹

Finally, under the following two circumstances, a preliminary agreement may be deemed to be equivalent to a final contract allowing for a claim for specific performance or expectancy damages. First, if one party to the preliminary agreement has performed the main obligations anticipated in the future contract and the other party accepts the performance. Second, the preliminary agreement incorporates all the material or essential terms of the proposed transaction, including subject matter, quantity, price or remuneration, time of performance, and so forth. In such cases, the execution of the final contract is considered a mere formality.²⁵²

²⁴⁷ Zhou Jingping v. Hubei Fengshuoyuan Real Est. Co., 湖北鄂州中级人民法院(2020)鄂07民终308号 [2020 E07MZ No. 308] (Hubei Ezhou Intermediate People's Ct. Oct. 29, 2020) (China).

²⁴⁸ CCC, *supra* note 11, art. 586.

²⁴⁹ CCC, *supra* note 11, art. 587; Draft Judicial Interpretation on Contracts, *supra* note 212, art. 11; *see also* Jiang Fei v. Weihai Hengxin Real Est. Co., 山东威海中级人民法院(2021)鲁10民终2163号 [2021 L10MZ No. 2163] (Shandong Weihai Intermediate People's Ct. Sep. 11, 2021) (China) (holding no refund of earnest money due to breaching party's request for reduction of an agreed to price).

²⁵⁰ Section 1590 of the French Civil Code of 1804 states that in a contract to sell a "payment of a deposit (*arrhes*)" is made; in the event the buyer withdraws then "the one who paid the deposit forfeits it;" if the withdrawing party is holder of the deposit (seller), "the one who received, must return double the amount."

²⁵¹ *See* CCC, *supra* note 11, art. 588(2).

²⁵² Draft Judicial Interpretation on Contracts, *supra* note 212, art. 10; Judicial Interpretation on Commodity House, *supra* note 198, art. 5; *see also* Haikou Lvyuan Real Est. Dev. Co. v. Guo Jianxing, 海南海口中级人民法院(2019)琼01民终612号 [2019 Q01MZ No. 612] (Hainan Haikou Intermediate People's Ct. Apr. 16, 2019) (China); Inner Mongolia Yuanda Real Est Co. v. Wang Lajun, 内蒙古呼和浩特中级人民法院(2019)内01民终3634号 [2019 N01MZ No. 3634] (Inner Mongolia Hohhot Intermediate People's Ct. Nov. 5, 2019) (China) (both deeming a preliminary agreement containing the main terms of the final contract enforceable and granting specific performance).

V. PRELIMINARY AGREEMENTS IN ANGLO-AMERICAN LAW

This part examines the place of preliminary agreements in Anglo-American law. It first examines the blurry line between precontract and contract. The presumption is that such agreements are non-enforceable, but there is a trend toward the implication of a duty to negotiate in good faith in some preliminary agreements. This part will also examine the split between American and English law on the use of the doctrine of promissory estoppel as the basis for a claim of reliance on a promise or assurance.

A. Introduction

The divergence between the civil law's recognition of a duty of good faith negotiations and the common law's rejection of such a duty is not as obvious in the area of preliminary agreements. The pervasive application of the duty of good faith in some civil law systems suggests that such a duty applies to preliminary agreements. Even when a preliminary agreement has a disclaimer of liability or indicates that the parties are not bound until the consummation of a formal contract, the duty of good faith still applies. American common law recognizes an implied duty of good faith in all contracts, while English law does not.²⁵³ Both jurisdictions agree that a duty of good faith does not apply to negotiations, but there have been cracks in this rule as more courts have found detailed agreements to be enforceable as is, and other courts have recognized that some preliminary agreements require negotiation in good faith.

Professors Choi and Triantis, in a 2020 article *Designing and Enforcing Preliminary Agreements*,²⁵⁴ asserted that: "Preliminary agreements . . . often create legal obligations, particularly a duty to negotiate in good faith . . . and yet continues to be regarded as a confusing and unpredictable issue in contract law."²⁵⁵ They further argue that preliminary agreements should "be thought of as setting ground rules for negotiations, which may include obligations of confidentiality, disclosure, and exclusivity."²⁵⁶ In such agreements, courts should first attempt to determine the intent of the parties to be bound by a duty

²⁵³ Martin A. Hogg, *The Implication of Terms-in-Fact: Good Faith, Contextualism, and Interpretation*, 85 GEO. WASH. L. REV. 1660, 1660 (2017) ("U.S. contract law has a rich heritage of good faith jurisprudence. By contrast, the good faith jurisprudence of the United Kingdom is relatively underdeveloped.")

²⁵⁴ Choi & Triantis, *supra* note 18.

²⁵⁵ *Id.* at 439.

²⁵⁶ *Id.* at 440.

to negotiate in good faith.²⁵⁷ This intent may be implied based on trade usage, such as whether the need for contractual formality (formal written contract) is presumed in a particular industry.²⁵⁸ For example, an intent to negotiate in good faith is implied in numerous preliminary agreements including: intellectual-property licenses, leases, bank loans, venture-capital financing, and corporate mergers and acquisitions.²⁵⁹ Some agreements commonly express obligations, such as in letters of intent in M&A transactions which commonly include express stipulations as to which provisions are binding (such as exclusivity, confidentiality, and expense reimbursement).²⁶⁰

The idea that a preliminary agreement may be considered a contract to negotiate in good faith is still the exception among Anglo-American courts, even though a theory of implying a good faith duty on the parties to a preliminary agreement is a sound one. The context of the agreement is the key, and the focus is on whether there was actual and substantial reliance of one party on the conclusion of the contract.²⁶¹ The case for the implication of such a duty is bolstered in cases where the relying party incurred substantial expenses to continue the negotiations or would suffer substantial damages if a contract is not concluded. When such harm is foreseeable and the termination of negotiations was due to bad faith acts, some common law courts, especially in the U.S., have recognized a cause of action for damages. The case law is far from clear as to what type of preliminary agreement and context overcomes the presumption of nonenforceability. What is clear is the likelihood of liability increases in cases where the harm caused was foreseeable at the time of the execution of the preliminary agreement, the agreement or promise given is more definite, and the reliance is substantial.²⁶²

Over the last few decades, there has been a trend in common law systems to recognize a general implied duty of good faith. This applies not only in the

²⁵⁷ *Id.* at 446.

²⁵⁸ *See, e.g.,* *Brown v. Cara*, 420 F.3d 148, 157 (2d Cir. 2005); *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 72 (2d Cir. 1989).

²⁵⁹ Choi & Triantis, *supra* note 18, at 448.

²⁶⁰ *Id.* at 448 n.24.

²⁶¹ One scholar suggests that “the disappointment of reliance is the common element of all doctrines relating to precontractual liability.” ZULOAGA, *supra* note 153, at 1.

²⁶² ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 8.9, at 45–58 (1963) (“The more free and more flexible the court is willing to be in determining the extent of the recovery, the more variation is made possible in applying such a requirement as that the conduct in reliance must be ‘substantial.’”).

United States²⁶³ but also in Canada²⁶⁴ and Australia,²⁶⁵ which have all aligned with civil law in adopting the duty of good faith in the performance and enforcement of contracts. It is plausible to argue that, in time, there will be a greater recognition that some preliminary agreements create an obligation to negotiate in good faith.

B. *Negotiations and Preparatory Agreements*

Nili Cohen rationalizes the nonenforceability of preliminary agreements because enforcing them would be an affront to freedom *from* contract.²⁶⁶ This negative freedom to negotiate and not enter into a contract is based on the recognition of formalities, such as the statute of frauds²⁶⁷ and consideration, as well as the adversarial nature of the common law.²⁶⁸ Thus, reaching an agreement is only one requirement in creating an enforceable contract. Cohen further asserts that to impose liability prior to satisfying required formalities “would be contradictory to the very existence of those requirements.”²⁶⁹ The common law’s hesitancy to recognize the enforceability of such agreements is premised on two pillars of contract law: limited scope of irrevocable offers and a rejection of a duty of good faith in the negotiations.

²⁶³ The duty of good faith has been part of American law since the adoption of the Uniform Commercial Code in the late 1960s and early 1970s.

²⁶⁴ In 2014, the Supreme Court of Canada, in *Bhasin v. Hrynew*, affirmed an “organizing principle of good faith” relating to the rights and obligations of contracting parties. *Bhasin v. Hrynew*, [2014] S.C.R. 494, para. 62 (Can.).

²⁶⁵ The Supreme Court of Australia recognized the implied duty of good faith in *Renard Constrs (ME) Pty Ltd v. Minister for Pub Works* [1992] 26 NSWLR 234 (Austl.).

²⁶⁶ Nili Cohen, *Pre-Contractual Duties: Two Freedoms and the Contract to Negotiate*, in *GOOD FAITH AND FAULT IN CONTRACT LAW, GOOD FAITH AND FAULT IN CONTRACT LAW* 25–56 (Jack Beatson & Daniel Friedmann eds., 1997).

²⁶⁷ The statute of frauds (requirement of written form) has been repealed in English law. While the general rule in the U.S. is oral agreements are fully enforceable, the written form is required in certain types of contracts (real estate, guarantees, wills and trusts, contract not performable within one year, sale of goods). See *NEW YORK STATE LAW OF OBLIGATIONS* § 5-701.

²⁶⁸ Consideration is generally thought as a substantive law doctrine where the courts would weigh the adequacy of the consideration being exchanged. In modern law, it is a mere formality that only requires sufficient legal consideration (any consideration). See *RESTATEMENT SECOND*, *supra* note 16, § 79 (“If the requirement of consideration is met, there is no additional requirement of equivalence of values.”). As to the adversarial nature of common law bargaining, see Cohen, *supra* note 266, at 28 (citing Lord Ackner in *Walford v. Miles* [1992] 2 AC 128 (HL) 138).

²⁶⁹ Cohen, *supra* note 266, at 27.

C. *Matter of Interpretation*

Most contract disputes are caused and resolved by interpreting the meaning of the contract's terms and implication of terms to fill in gaps.²⁷⁰ This is also the case with preliminary agreements. Courts have to determine if an agreement reaches the threshold of an enforceable contract, whether the parties intended to be obligated to negotiate in good faith, or whether a party should be awarded damages for harm caused by the reliance on the other party's promises.

1. *Presumption of Nonenforceability*

The common law, premised on the norms of predictability and certainty, has generally refused to find a duty to negotiate in good faith in preliminary agreements where there are missing material terms, uses of disclaimer of liability language, or preconditions liability on the execution of a formal contract. In the first case, such instruments are considered to be too indefinite to enforce or *nudum pactum*.²⁷¹ At the same time, the common law favors the enforcement of agreements where there is an intent to be bound despite the uncertainty of missing terms: "the law does not favor but leans against the destruction of contracts because of uncertainty; and it will, if feasible construe agreements to carry into effect the reasonable intentions of the parties."²⁷² In American law, this idea of enforceability is epitomized by Article 2 of the Uniform Commercial Code (UCC), which has a narrow view of what constitutes a material term. In essence, a sales contract is still enforceable despite missing terms or conflicting terms in the offer and acceptance.²⁷³

Often preliminary agreements incorporate contradictory language, such as a disclaimer of liability and duty to negotiate in good faith. In the seminal English case of *Rose & Frank Co. v. JR Crompton & Bros.*,²⁷⁴ the House of Lords considered a written memorandum, despite a litany of bargained for promises,

²⁷⁰ See J.W. CARTER, THE CONSTRUCTION OF COMMERCIAL CONTRACTS (2013) (explaining the process of how law applies to the meaning of a contract).

²⁷¹ See *Hunt Investors v. Extengine Transp. Sys.*, 2010 Cal. App., LEXIS 8679, *2, *37-38 (Cal. App. 2010). The definiteness requirement of the common law requires the parties to reach agreement on all material terms in order for the agreement to be enforceable. Even if the parties achieve the bargain element, the incompleteness of important terms might preclude the bargain from being fully contingent. JP Kostritsky, *Bargaining with Uncertainty, Moral Hazard and Sunk Costs: A Default Rule for Precontractual Negotiations*, 44 HAST. L.J. 621, 624, 705 (1993) (proposing that "the courts adopt a default rule imposing liability during precontractual negotiations by incorporating the terms of the parties' implicit bargain.").

²⁷² *California Lettuce Growers v. Union Sugar Co.*, 45 Cal. 2d 474, 481 (Cal. 1955).

²⁷³ See U.C.C. § 2-207 (Am. L. Inst. & Unif. L. Comm'n 1977) (battle of the forms).

²⁷⁴ *Rose & Frank Co. v. JR Crompton & Bros* [1925] AC 445 (HL).

which included a statement that the agreement was “not intended as a formal or legal agreement.”²⁷⁵ The court acknowledged the language of promise or obligation stating that it is a “definite expression and record of the purpose and intention of the parties concerned, to which they each honorably pledge themselves in the fullest confidence—based on past business with each other—that it will be carried through by each of the parties with mutual loyalty and friendly co-operation.”²⁷⁶ However, the court disregarded the more in-depth language of commitment and held the agreement to be unenforceable because of the use of the disclaimer language.

More recently, even though good faith is not implied to the negotiation phase, American courts have responded to acts of bad faith in the negotiation of contracts:

There is evidence that courts will respond to the element of bad faith when it is clearly present. If the law persists in declaring bad faith irrelevant in the negotiation process, the court which is faced with clear bad faith conduct will be forced either to find a complete contract where in the absence of bad faith no such contract would be found, or else to write an opinion in which bad faith conduct is either condoned or ignored.²⁷⁷

Courts have also questioned the value of the presumption of nonenforceability. In the English case of *Capital Landfill (Restoration), Ltd. v. William Stockler & Co.*,²⁷⁸ the court applied a heightened level of scrutiny that belied the existence of a presumption of nonenforceability:

The question comes down to whether this letter was intended simply as a comfort letter . . . or whether it was intended by the parties as a legal document binding the company strictly to its terms. These are questions that cry out to be clarified by oral evidence, and [cannot be] based simply on the wording of this alleged undertaking.²⁷⁹

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ Charles L. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 727 (1969).

²⁷⁸ *Capital Landfill (Restoration), Ltd. v. William Stockler & Co.* [1991] Lexis Citation 1630 (AC) (appeal taken from Eng.).

²⁷⁹ *Id.*

In the U.S., there is substantial case law recognizing preliminary agreements as sufficiently complete to be binding contracts, even though the parties intended to enter into a more formal contract.²⁸⁰

2. *Content and Context*

As noted previously, the increased acknowledgement of contextual factors has increased the likelihood of a court finding a binding duty to negotiate in good faith in preliminary agreements.

An American court in *Teachers Insurance and Annuity Association of America v. Tribune Co.*²⁸¹ recognized the following factors to be weighed in determining whether an enforceable obligation exists: (1) review language of the agreement “to determine whether a preliminary manifestation of assent should be found to be a binding commitment”;²⁸² (2) “existence of open terms”;²⁸³ (3) extent of any reliance investments, such as partial performance;²⁸⁴ and (4) the customary practice regarding formalities such as, “whether in the relevant business community, it is customary to accord binding force to the type of informal or preliminary agreement at issue.”²⁸⁵ In sum, the analysis of preliminary agreements has become more nuanced, complicated, and contextual. The movement away from a purely textual interpretation, such as recognizing disclaimer language as pivotal, to a broader analysis opens greater possibilities for finding binding obligations to negotiate in good faith.

Charles Knapp has noted that courts are not obligated to make a generalized binary decision that a preliminary agreement is enforceable or unenforceable as a standalone contract: “If [the parties] have made such an agreement, the law has no business telling them their act of agreement was devoid of legal significance. Nor is the court, in characterizing that agreement, obliged to choose between only two labels, complete contract or mere negotiation.”²⁸⁶ The court should analyze the content and the context of a preliminary agreement that

²⁸⁰ See *Valcold & Immunotherapy v. Cerami*, No. 00-4024, 2002 U.S. Dist. LEXIS 1895, at *2, *12 (S.D.N.Y. 2002); *Fairbrook Leasing Inc. v. Mesaba Aviation, Inc.*, 295 F. Supp. 2d 1063, 1069–71 (Dist. Ct. Minn. 2003); *Tiburzi v. Dept. of Justice*, 269 F.3d 1346, 1352 (Fed. Cir. 2001); *Scholastic Inc. v. Harris*, 80 F. Supp. 2d 139, 147 (S.D.N.Y. 1999); *Shaftel v. Dadras*, 39 F. Supp. 2d 217, 226 (E.D.N.Y. 1999).

²⁸¹ *Teachers Ins. & Annuity Ass’n of Am. v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987).

²⁸² *Id.* at 498.

²⁸³ *Id.* at 499, 501–02.

²⁸⁴ *Id.* at 502.

²⁸⁵ *Id.* at 503.

²⁸⁶ Knapp, *supra* note 277, at 728.

causes real harm in determining the existence of binding obligations, such as a duty to negotiate in good faith and the duty to keep any shared information confidential. The more detailed the context, the more likely a court may provide a claim to the harmed party. In the common law, the usual remedy is reliance-based recovery.²⁸⁷

As previously noted, the language of such agreements is often internally contradictory or repugnant, in that there is language of promise along with language of disclaimer from any liability.²⁸⁸ The English court in *Rose & Frank Co. v. Crompton & Bros.* held that an “honourable pledge” implies only a moral and not a legal obligation.²⁸⁹ English law subsequently developed to hold that the existence of any disclaimer language rendered an agreement unenforceable, no matter how detailed the language of promise or obligation. In *Chemco Leasing SpA v. Rediffusion Plc.*, Justice Staughton recalled Justice Vaisey’s sardonic definition of such agreements as a “gentlemen’s agreement . . . which is not an agreement, made between two persons neither of whom is a gentleman, whereby each expects the other to be strictly bound without [itself] being bound at all.”²⁹⁰ But that is not the end of the story since other common law rules of interpretation come into play in cases where the agreement is provided by one of the parties and there is uncertainty as to the agreement’s enforceability. The *contra proferentem* rule²⁹¹ holds that “in the case of ambiguity when all other rules of construction fail, the doubt is removed by construing the document adversely to the [drafter].”²⁹² The rule favors the receiving party of such an instrument if the party subsequently makes a claim based on the agreement’s enforceability.

D. Spectrum of Preliminary Agreements

The American Second Circuit court in *Adjustrite Systems v. GAB Business Services* addressed what it sees as an important distinction in types of preliminary agreements:²⁹³

²⁸⁷ “The remedy granted for breach [of a promise] may be limited as justice requires.” RESTATEMENT SECOND, *supra* note 16, § 90 (1). This has generally been interpreted to mean reliance damages, which covers the costs expended by a party pursuant to the negotiations.

²⁸⁸ *Rose & Frank Co.*, [1925] AC 445.

²⁸⁹ *Id.* at 446.

²⁹⁰ *Chemco Leasing SpA v. Rediffusion Plc.* [1985] Lexis Citation 1005 (QB).

²⁹¹ *Contra proferentem* means “against the drafter” in Latin. In contract interpretation, it means any ambiguity is to be interpreted against the drafting or in a way most favorable to the non-drafter.

²⁹² See *Glynn v. Margetson* [1893] AC 351 (HL).

²⁹³ *Adjustrite Systems, Inc. v. GAB Business Services, Inc.*, 145 F.3d 543, 548 (2d Cir. 1998).

[B]inding preliminary agreements fall into one of two categories. The first is a fully binding preliminary agreement, which is created when the parties agree on all the points that require negotiation (including whether to be bound) but agree to memorialize their agreement in a more formal document. Such an agreement is fully binding; it is “preliminary only in form—only in the sense that the parties desire a more elaborate formalization of the agreement.” The second type of preliminary agreement, dubbed a “binding preliminary commitment” by Judge Leval, is binding only to a certain degree. It is created when the parties agree on certain major terms, but leave other terms open for further negotiation. . . . In contrast to a fully binding preliminary agreement, a “binding preliminary commitment” “does not commit the parties to their ultimate contractual objective but rather to the obligation to negotiate the open issues in good faith in an attempt to reach the . . . objective within the agreed framework.” A party to such a binding preliminary commitment has no right to demand performance of the transaction. Indeed, if a final contract is not agreed upon, the parties may abandon the transaction as long as they have made a good faith effort to close the deal and have not insisted on conditions that do not conform to the preliminary writing.²⁹⁴

Thus, in 1998, an American appeals court recognized that a preliminary agreement with missing terms, although not binding as a final contract, could be the basis for implying a duty of good faith negotiation.

1. Agreement to Negotiate in Good Faith or Agreement to Agree

A California court in *Copeland v. Baskin Robbins U.S.A.*²⁹⁵ made the distinction between unenforceable agreements to agree and enforceable agreements to negotiate. But such a distinction is a matter of semantics; as noted above, the context of the agreement is as important as how the agreement is titled or described. In practice, the terminology regarding preliminary agreements has been inconsistent. For example, agreements to agree have been interpreted as unenforceable, while other courts and scholars have used the term to support the argument that such agreements are contracts to negotiate in good faith.

In some civil law countries, especially those influenced by the French legal tradition, the duty to negotiate in good faith is found in the law of delict (tort).²⁹⁶ One party to the negotiations or preliminary agreement is seen as having a duty

²⁹⁴ *Id.* at 548.

²⁹⁵ *Copeland v. Baskin Robbins U.S.A.*, 96 Cal. App. 4th 1251, 1257 (Cal. Ct. App. 2002).

²⁹⁶ *Supra* Section III.A.

of care to the other based on trust and good faith. Thus, an action in tort for bad faith negotiations would be supported in cases where a party believed an enforceable contract had been agreed upon, while the other party knew of the other's false belief because required formalities had not been met. In other jurisdictions, such as in Germany, courts have reasoned that the party with knowledge has a contractual duty to inform the other party of the needed formalities.²⁹⁷ This type of fault may be the basis for a remedy under the principle of *venire contra factum proprium* (inconsistent behavior) or the principle of *culpa in contrahendo*.²⁹⁸ Similar to the civil law, the American version of promissory estoppel allows for a claim based on reliance on a promise in an otherwise unenforceable preliminary agreement.²⁹⁹

A quandary occurs for the common law judge when parties expressly agree to negotiate in good faith. On the one hand, freedom of contract favors the enforcement of agreements where the parties show an intent to be bound, and on the other hand, the common law rejects such a duty in the negotiations of contracts. The English law approach “refuses to recognise a pre-contractual duty to negotiate in good faith and will neither enforce such a duty when it is expressly agreed upon nor imply it when it is not.”³⁰⁰ Lord Denning in *Courtney & Fairbairn Ltd. v. Tolaini Brothers* argued that since “the law does not recognise a contract to enter a contract; it seems to me it cannot recognise a contract to negotiate. The reason is because it is too uncertain to have any binding force.”³⁰¹ Denning also notes that any such agreement would fail due to the uncertainty in establishing damages. Denning seems to be alluding to expectancy damages because there is no assurance that the parties would have reached a final contract. Previously, Lord Ackner in *Walford v. Miles* stated that: “The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations.”³⁰² Thus, English law has been rigid in rejecting the bindingness of a contract to negotiate in good faith.

²⁹⁷ *Supra* Section II.B.

²⁹⁸ ZULOAGA, *supra* note 153, at 49–54.

²⁹⁹ In referencing Section 90 of the RESTATEMENT SECOND, Yorio and Thel assert: “The section has had a profound influence on the law of contracts because it ratifies cases enforcing a promise in the absence of bargained-for consideration.” Edward Yorio & Steve Thel, *The Promissory Basis of Section 90*, 101 YALE L.J. 111, 111 (1991).

³⁰⁰ *Little v. Courage Ltd.* [1995] BCLC 164.

³⁰¹ *Courtney & Fairbairn Ltd. v. Tolaini Bros. (Hotels) Ltd.* [1975] 1 All ER 716, 720; *see also* Charles Shaker v. Vistajet Group Holdings SA, [2012] EWHC (Comm) 1329 (Eng.).

³⁰² *Walford v. Miles* [1992] UKHL, [1992] 2 AC 128 (HL) 138.

Hence, the vagueness of the language in precontractual agreements has been the main rationale for English courts rejecting their bindingness. In *Kleinwort Benson Ltd. v. Malaysia Mining Corp.*,³⁰³ a parent company sent a letter of assurance, often referred to as a comfort letter, to a bank contemplating the giving of a loan to one of the parent's subsidiaries. The letter stated that it was the parent company's "policy to ensure that [its subsidiary] is at all times in a position to meet its liabilities . . . under [the loan facility arrangements.]"³⁰⁴ The court held that the language was merely a moral but not a contractual promise. Another English case involved a letter of intent that provided for the delivery of goods while the contract was still under negotiation.³⁰⁵ The goods were never paid for, leading the seller to bring a claim for breach of a unilateral contract. The court focused less on the language of the letter of intent, but on what the letter failed to say: since the parties "were still in a stage of negotiation, it is impossible to say with any degree of certainty what the material terms of that contract would be."³⁰⁶ It was noted that the letter did not state the price, delivery dates, and other applicable terms. The court held that the seller's delivery was in anticipation of a formal written contract, but that contract never came into existence, and, therefore, no contractual obligations had been formed.

In an "agreement in principle," the parties pronounce that they have an agreement in hand on all material terms. The agreement in principle can be seen as something well beyond mere negotiations and closer to a final contract. Despite the resemblance to a formal contract, the common law still regards such an agreement as a non-binding preparatory step and does not require the parties to continue negotiations in good faith.³⁰⁷ This distinction between vague agreements and detailed ones shows that the courts choose form over substance. For example, no matter how detailed the agreement in principle may be, the use of "subject to" (signing a formal contract) language makes it non-binding.³⁰⁸

The focus on form and labels creates a bright line rule that all preliminary agreements are either enforceable or non-enforceable. It fails to recognize that the line is always a blurry one that will need to be analyzed on a case-to-case basis based on numerous factors. The American court in *Vacold LLC v.*

³⁰³ *Kleinwort Benson Ltd. v. Malaysia Mining Corp.*, [1989] 1 All ER 785 (CA).

³⁰⁴ *Id.* at 785.

³⁰⁵ *British Steel Corp. v. Cleveland Bridge & Engineering Co.* [1984] 1 All ER 504 (QB).

³⁰⁶ *Id.* at 510.

³⁰⁷ BEALE ET AL., *supra* note 51, at 359.

³⁰⁸ *Id.*

Cerami,³⁰⁹ proposed a three-factors analysis. The first factor is to analyze the language of the agreement to see if it expressly states that the parties will not be bound in the absence of a further, definitive written instrument.³¹⁰ If there is language of disclaimer of liability, then the common law courts have traditionally held the agreement to be unenforceable. However, in a factors analysis, such language would be considered as just one factor. The second factor looks extrinsically to the context of the negotiations. The context of the negotiations may suggest that the parties sought “determinateness and certainty . . . , not flexibility and optionality subject to the parties’ good-faith efforts to reach agreement as to open issues.”³¹¹ The third factor is the determination of whether the parties intended a binding agreement with open terms.³¹² The existence of open terms (to be determined in the future) is evidence favoring a finding of an enforceable agreement.³¹³ These factors are used to determine the intent of the parties to be bound or not to be bound: if the parties intended to be bound, “‘courts should not frustrate their achieving that objective or disappoint legitimately bargained for expectations,’ provided that the agreement is not so ‘fragmentary’ as to be ‘incapable of sustaining binding legal obligations.’”³¹⁴

Charles Knapp argues that an agreement to agree is a “contract to bargain,”³¹⁵ which “creates a present duty to bargain in good faith, in the process of attempting to reach a final agreement.”³¹⁶ In *Gillenardo et al v. Conner Broadcasting Delaware Company*,³¹⁷ the court held that in a letter of intent to purchase a radio station, the parties intended to enter binding obligations “to attempt in good faith to finalize the Sale Agreement,” a “duty to work diligently to complete the Sale Agreement” and a “duty not to solicit, accept or entertain any other offers while the letter of intent was in effect.”³¹⁸ *RGC International Investors, LDC v. Greka Energy Corp.*³¹⁹ involved the merger of companies in

³⁰⁹ *Vacold LLC v. Cerami*, 545 F.3d 114 (2d Cir. 2008).

³¹⁰ *Id.* at 125.

³¹¹ *Id.* at 128.

³¹² “A preliminary agreement with open terms sets out most of the terms of the deal and the parties agree to be bound by these terms . . . [in the event the parties fail to agree on the open terms] the other matters are governed by whatever terms a court will supply.” FARNSWORTH, *supra* note 8, at 232.

³¹³ *Vacold LLC*, 545 F.3d at 128.

³¹⁴ *Id.* (quoting *Teachers Ins. & Annuity Ass’n of America v. Tribune Co.*, 670 F. Supp. 491, 497, 499 (N.Y.S.D. 1987)).

³¹⁵ Knapp, *supra* note 277, 684–86.

³¹⁶ *Id.* at 685.

³¹⁷ *Gillenardo v. Conner Broad. Del. Co.*, 2002 Del. Super. LEXIS 402 (Del. Super. Ct. 2002).

³¹⁸ *Id.* at *22.

³¹⁹ *RGC int’l Investors, LDC v. Greka Energy Corp.*, 2001 Del. Ch. LEXIS 107 (Del. Ch. 2001).

which the parties signed a term sheet, where the parties stated their mutual agreement to negotiate in good faith. The court noted that the term sheet was a “thoroughly negotiated, detailed document;” one party “materially altered their position in reliance upon the accord outlined in the term sheet,” and the other party “was responsible for the breakdown in the negotiations.”³²⁰ The court further noted that the one party had committed numerous acts of bad faith, such as “purposefully and persistently ignore[ing] the obligations it had assumed under the Term Sheet.”³²¹ Finally, in *Horphag Research Ltd. v. Henkel Corp.* the court analyzed a settlement letter in which the terms were not complete or definitive.³²² Nonetheless, the court held it could be sufficient to support a finding that there was “an agreement on major terms with others to be negotiated” and included an enforceable obligation to negotiate in good faith.”³²³ In sum, an agreement to negotiate in good faith has increasingly been recognized by American courts as creating binding obligations.

2. *Promise, Reliance Theory, and Promissory Estoppel*

Preliminary agreements challenge the promissory centered basis of contract law, which focuses on the intent of the promisor. Reliance theory provides an alternative avenue of liability based on the reliance of a party (promisee) on another party’s promise.³²⁴ Reliance damages are often awarded in order to prevent an injustice when a non-contractual promise is given and relied upon. Since the promise is non-contractual (not part of a binding contract), courts generally award out-of-pocket expenses or reliance damages and do not award lost profits or expectancy damages.³²⁵ Alan Schwartz and Robert Scott further argue that when there has been detrimental reliance on another party’s promise, the promisor’s act of bad faith in terminating the negotiations should enhance the possibility of liability.³²⁶

³²⁰ *Id.* at *3–4.

³²¹ *Id.* at *5.

³²² *Horphag Research Ltd. v. Henkel Corp.*, 115 F. Supp. 2d 455, 457 (S.D.N.Y.2000).

³²³ *Id.* at 458.

³²⁴ See Charles Knapp, *Reliance in the Revised Restatement: The Proliferation of Promissory Estoppel*, 81 COLUM. L. REV. 52 (1980); Jay Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678 (1984).

³²⁵ Alan Schwartz & Robert Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661, 663 (2007).

³²⁶ “The emerging legal rule requires parties to such preliminary agreements to bargain in good faith over open terms.” *Id.* at 664. “The conventional wisdom among contemporary scholars is that courts will sometimes impose liability for reliance investments undertaken before any agreement between the parties.” *Id.* at 668 (citing RESTATEMENT (1981) § 205, cmt. c (1981) (“Bad faith in negotiation . . . may be subject to sanctions.”)).

Anglo-American contract law has often used promissory estoppel, also referred to as detrimental reliance, to fill in gaps in determining the enforceability of a contract. Promissory estoppel has been used to satisfy requirements needed to form contracts to prevent an injustice. Thus, an oral agreement that needed to be in writing (such as in the sale of real estate) or a contract lacking consideration may be saved by estopping the counter-party from arguing the unenforceability based on the missing element. Justice Cardozo, in the seminal case of *Allegheny College v. National Chautauqua County Bank*,³²⁷ explained that “there has grown up of recent days a doctrine that [is] a substitute for consideration or an exception to its ordinary requirements . . . found in what is styled ‘a promissory estoppel.’”³²⁸ The *Allegheny* case involved what was previously an unenforceable gift promise or charitable subscription. Cardozo found “the doctrine of promissory estoppel as the equivalent of consideration in connection with [the] law of charitable subscriptions [and that new case law recognizes] . . . the doctrine of consideration as qualified by the doctrine of promissory estoppel.”³²⁹ Cardozo goes further by asserting that consideration as a substantive requirement of contract had passe, and it now acted as a mere formality, noting that it is “a concept which itself came into our law, not so much from any reasoned conviction of its justice, as from historical accidents of practice and procedure.”³³⁰ He concluded that the notoriety gained by the donor was sufficient consideration that created a bilateral contract.³³¹

Promissory estoppel became ensconced in American law by its recognition in section 90 of the 1932 *Restatement of Contract Law*,³³² which states that “a promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee, and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.”³³³ Thus, the three requirements of promissory estoppel are a promise or assurance, reasonable reliance on the promise, and a finding that an injustice would be done if not enforced. Professor Corbin, a major advocate for the insertion of section 90 into the *Restatement*, discusses the four stages in the evolution of promissory estoppel: (1) use as

³²⁷ *Allegheny College v. National Chautauqua County Bank*, 159 N.E. 173 (N.Y. 1927).

³²⁸ *Id.* at 373–74.

³²⁹ *Id.* at 374.

³³⁰ *Id.* at 375.

³³¹ *Id.* at 377.

³³² The Restatements of the Law are a set of treatises, sponsored and published by the American Law Institute, on legal subjects that seek to inform judges and lawyers about general principles of common law.

³³³ RESTATEMENT (FIRST) OF CONTRACTS § 90 (AM. L. INST. 1932) (emphasis added).

defensive and offensive form of equitable estoppel; (2) use as a consideration substitute in contractual claims; (3) use as an independent claim for detrimental reliance; and, finally, (4) use as an equitable tool, with solely equitable rights and remedies.³³⁴ The 1981 *Restatement (Second) of Contracts* (*Restatement Second*) deletes the *First Restatement's* requirement that the reliance be “of a definite and substantial character.”³³⁵ Thus, the newer version broadens the scope of promissory estoppel because something less than substantial harm will suffice.

The difference between English and American common law is that under English law, promissory estoppel can only be used defensively, such as a substitute for consideration. Stage 3 of Corbin’s analysis recognizes its use offensively as a separate cause of action. Under the American version, a promise may be enforced by a claim of damages if there has been reasonable reliance.³³⁶ In *Schmidt v. McKay*, the court asserted that “[u]nder New York law the essence of either a claim of promissory estoppel or a claim of breach of contract is a claim of damages for breach of promise.”³³⁷ As noted above, in the first case, the party is limited to reliance damages (placing the party in the position it was in before the negotiations) and, in the latter, expectancy damages (placing the party in the future position it would have been if not for the breach) are awarded.

Most important for the current discussion, promissory estoppel can be used to enforce promises made in unenforceable preliminary agreements. Furthermore, promissory estoppel’s relationship with the implication of the duty of good faith in preliminary agreements was noted by a California court³³⁸ as “just a different rubric for determining the enforceability of a contract to negotiate an agreement.”³³⁹ The court found that a party acted in bad faith when it proposed new material terms on the day before the closing of the transaction. Like most claims, a given fact pattern may support numerous causes of action.

³³⁴ CORBIN, *supra* note 262, § 8.11, at 45–58.

³³⁵ A court held that estoppel may overcome the writing requirement where the agreement induces or permits “another party to the agreement to do acts, pursuant to and in reliance upon the agreement, to such an extent and so *substantial* in quality as to *irremediably alter* his situation.” *Philo Smith & Co. v. USLIFE Corp.*, 554 F.2d 34, 36 (1977) (emphasis added) (quoting *Woolley v. Stewart*, 118 N.E. 847, 848 (N.Y. App. Ct. 1918)). “For this reason, the doctrine of promissory estoppel is properly reserved for that limited class of cases where ‘the circumstances are such as to render it *unconscionable* to deny.’” *Id.* (emphasis added) (citing 3 WILLISTON ON CONTRACTS § 533A, at 801 (3d ed. 1960)).

³³⁶ CORBIN, *supra* note 262, § 204; 1 SAMUEL WILLISTON & WALTER H.E. JAEGER, A TREATISE ON THE LAW OF CONTRACTS § 140 (3d ed. 1957).

³³⁷ *Schmidt v. McKay*, 555 F.2d 30, 36 (2d Cir. 1977).

³³⁸ *Copeland v. Baskin Robbins U.S.A.*, 117 Cal. Rptr. 2d 875 (2002).

³³⁹ *Linhardt*, *supra* note 47, at 22 (quoting *Copeland*, 117 Cal. Rptr. 2d at 1262).

The court noted that the party may be liable on the grounds of fraud or interference with contractual relations, promissory estoppel, as well as for breach of an agreement to negotiate in good faith.³⁴⁰

VI. FINDINGS AND TRENDS

This part presents a summary of the findings of the comparative analysis of four major legal systems on the enforceability of preliminary agreements. It maps out distinctions between the different systems in the areas of the recognition of preliminary agreements as final contracts, preliminary agreements as standalone contracts to negotiate in good faith, and the creation of independent obligations despite the unenforceability of such agreements. It also examines the remedies available for breaches related to the above three scenarios. Finally, it concludes that the enforceability of such agreements has increased across legal systems and this trend is likely to broaden in the future.

A. *Enforceability of Preliminary Agreements*

Ironically in civil law countries, at first, rules on precontractual liability were found in case law and not the civil codes. The revisions of the codes studied in this article—Germany BGB in 2002, French Civil Code in 2016, and the Chinese Civil Code in 2021—now recognize this long brewing development in the case law. The issues of the enforceability of preliminary agreements arose in the case law due to a number of factors, including the civil law's recognition of a duty of good faith negotiations and the belief that freedom of contract should be respected. The latter principle looks to the consent (*solus consensus obligat*) of the parties and is often cited when courts rule that a preliminary agreement is in itself a fully binding contract.

Both in German and in French legal practice, a broad range of preliminary agreements are recognized and used. Some of these are regulated in the law while others are not. Although in theory there exists a clear distinction between agreements that have contractual characteristics and agreements that have no contractual force, in practice, the distinction between contractual and non-contractual agreements is blurry. The courts' interpretation of the parties' intent or will may lead to outcomes ranging from the absolute unenforceability of the parties' undertaking to the finding that the parties assumed limited pre-contractual duties (such as the duty to negotiate in good faith and the duty of

³⁴⁰ Linhardt, *supra* note 47, at 23.

confidentiality), to the recognition that the preparatory agreement is in fact a binding contract. In German law, there is a presumption against contractual commitment. The more detailed the terms of the agreement, the more probable that this presumption will be rebutted. It should be noted that in both jurisdictions, the general implied duty of good faith in contract negotiations may be heightened where a preliminary agreement exists.

In China, the law on preliminary agreements is still in its infancy, given the 2021 enactment of the first comprehensive CCC. The CCC supports a presumption in favor of enforceability; however, scholars and courts are far from reaching a consensus on which types of preliminary agreements are enforceable or the type of liability that should result from enforceability. There is a judicial consensus in Chinese courts that parties to preliminary agreements owe, at a minimum, a duty of good faith or reasonable best efforts to each other to conclude a contract.

The starting point in Anglo-American contract law is there is no implied duty of good faith in the negotiation of a contract, and the presumption is against the enforceability of preliminary agreements. But this presumption has been overcome more often in recent decades. The major trend is that good faith in negotiations cannot be implied-in-law but can be implied-in-fact. The Delaware Supreme Court, in a case involving a detailed letter of intent, held that “the parties obligated themselves to ‘make every reasonable effort’ to agree upon a formal contract, and . . . each side [was required] to attempt in good faith to reach final and formal agreement.”³⁴¹ Schwartz and Scott noted that there has been “a major shift in doctrine; courts have relaxed the knife-edge character of the common law by which parties are either fully bound or not bound at all.”³⁴² The presumption against enforceability and recognition of duties grounded in preliminary agreements has been replaced by a new default rule that recognizes “a mutual commitment to negotiate together in good faith in an effort to reach final agreement.”³⁴³

The major divergence in American and English common law involves the use of the doctrine of promissory estoppel to enforce pre-contractual promises. Both legal systems recognize promissory estoppel as akin to equitable estoppel

³⁴¹ *Itek Corp. v. Chicago Aerial Indus., Inc.*, 248 A.2d 625 (Del. 1968).

³⁴² Schwartz & Scott, *supra* note 325, at 675 (citing *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 74 (2d Cir. 1984)).

³⁴³ Schwartz & Scott, *supra* note 325, at 675 (citing *Teachers Ins. & Annuity Ass’n of Am. v. Tribune Co.*, 670 F. Supp. 491, 498 (S.D.N.Y. 1987)).

in preventing a party from raising a valid legal point that would ultimately result in an injustice. A party may be estopped in raising the Statute of Frauds or a lack of consideration when challenging the validity of a contractual obligation. American law has taken promissory estoppel a step further by recognizing it not only as a defensive mechanism but also as the basis of a cause of action. Thus, a party who relies on another party's non-contractual promise, such as in the case of an unenforceable preliminary agreement, may bring a claim in promissory estoppel if it reasonably relied on that promise.

B. Remedies for Breach of Preliminary Agreements

Since civil law views specific performance as an ordinary remedy in cases where preliminary agreements are deemed to be binding, Chinese, French, and German law, on the surface, allow the non-breaching party to obtain a specific performance order. Technically, in German law, specific performance is the only available remedy. A party may claim expectancy damages, including lost profits under German law only when specific performance is shown to be unavailable or impossible. But even non-binding preliminary agreements are not devoid of legal consequences since they may still be the bases for the recognition of pre-contractual obligations, which allows for a claim of reliance damages.

As noted above a major difference between civil law countries and Anglo-American law is that the former recognizes a duty of good faith negotiations, and the latter rejects any such duty. There are remedial consequences for this divergence, namely, that bad faith negotiations in the civil law is the basis for an action for damages. *Culpa in contrahendo* allows a party to sue for damages when there is a bad faith termination of negotiations, especially when that termination is done within the context of a preliminary agreement. It is at the court's discretion to choose from an array of damages from out-of-pocket expenses (reliance) to loss of opportunity to expectancy damages.

In the common law, breach of an unenforceable preliminary agreement is not actionable except for the independent obligations of confidentiality and exclusivity. The exception is, that under American law, a cause of action in promissory estoppel in cases where there has been a reasonable reliance on a promise found in the unenforceable preliminary agreement is actionable. However, damages are limited to reliance losses, but the court may also grant restitution and loss of opportunity damages in some cases.³⁴⁴ Finally, since

³⁴⁴ RESTATEMENT SECOND, *supra* note 16, §90.

specific performance is considered an extraordinary remedy in the common law, any such grant for breach of a preliminary agreement would be highly unusual.

CONCLUSION

The topic of the enforceability of preliminary agreements among businesspersons and of the legal consequences arising out of the breach of such (enforceable and unenforceable) preliminary agreements remains a daunting challenge in the countries surveyed in this paper: United States, England, China, France, and Germany. Preliminary agreements come in many sizes and shapes in virtually all sectors of the economy. Under all the national laws herein considered, rules about the enforceability of these agreements and on the liability stemming from their breach are highly nuanced and unclear. This lack of clarity is heightened across legal systems, due to the differences in the treatment of these agreements.

Differences across common law and civil countries, in particular, are significant. Our review has shown that there is a trend toward increased enforceability and liability across legal systems. There has also been a good degree of convergence with the Anglo-American recognition that parties may agree to a contract to negotiate in good faith, as well as the American recognition of the cause of action of promissory estoppel.

Nonetheless, differences remain, especially where the remedial scheme continues to adjust in response to the increased recognition of the substance of preliminary agreements. In recent times, these differences have become even more important as the clear divergences in national laws have given way to a murky middle ground. This lack of clarity is traceable to the common law's movement away from the presumption of non-enforceability of such agreements and the uncertainty relating to the interpretation of the new Chinese Civil Code. The current evolution in the area of pre-contractual liability should earn the attention of anyone engaged in international transactions, especially transactions characterized as long-term, complex, and technical.