Precontractual Agreements in the energy and natural resources industries - legal implications and basis for liability (civil law, common law and islamic law)

4.2 Unjust Enrichment

This is a fundamental ground for liability in situations where one of the parties benefits from the negotiations. The concept originated within the civil law tradition. A comparable concept under common law was that of restitution. The term, "unjust enrichment" seems to have been imported from continental Europe, especially from Roman law. The entire law of obligations appears to be based on the principle that unfair advancement at the expense of others is not allowed. This gives validity to the concept of unjust enrichment. It is measured in restitution interest to prevent a defaulting party benefiting with impunity and to return the wronged party to his status quo. The plaintiff has to prove that valuable services were rendered or materials accepted. The services and materials must have been utilised by the defendant with reasonable notification that the plaintiff expected to be paid. The amount of recovery would be quantum meruit. Mere benefit to the defendant does not guarantee a claim a restitution as it could be treated as part of the risk in negotiations.

In 1978, Lord Diplock stated that “there is no general doctrine of unjust enrichment in English law. What it does is to provide specific cases of what might be classified as unjust enrichment in a legal system that is based upon civil law”. Recent cases have shown the gradual establishment of the principle in English law. The Lipkin case and the Woolwich case have, as far as can be seen, irrevocably established unjust enrichment as an independent ground for relief under English law. In Scotland, the plaintiff could claim recompense but it is difficult to bring the claim within the special circumstances in which it will be entertained. These include that: 1.) the loss was wrongfully caused, but not as part of the abortive negotiations; 2.) there was no excuse for the wrong; 3.) the plaintiff is not responsible for the loss. In the U.S., the defendant must have requested the plaintiff's services. If the plaintiff shows this, he can establish a claim based on a contract implied in fact for the reasonable value of those services. Thus, he would avoid having to prove that the services actually benefited the defendant. Recovery is here measured by restitution interest.

Under Islamic law, the Quran prohibits profits which are in violation of justice. Muslim jurists have also recognised the obligation in situations involving unjust gain. This resulted in the principle that a sum paid without obligation should be restored to the payer. This should be done irrespective of the fact that the payment was made in error, for an illegal purpose or for an unfulfilled purpose. Restitution is based on quantum meruit with the compensation being commensurate with the unjust enrichment. This would apply even if there is no contract.
4.3 Good Faith/Fair Dealing

The phrase "good faith" is used in a variety of contexts and its meaning varies depending on the context. Good faith generally implies fidelity to an agreed common purpose and consistency with the justified and practical expectations of the other negotiating party. It excludes behaviour which could be characterised as "bad faith" in that it violates the standards of decency, fairness or reasonableness of the community. When parties negotiate, it is tacit that they have a serious intention to reach an agreement. What if a party has no intention of reaching an agreement but deliberately or carelessly uses words that give the other party a contrary impression? It may be argued that there is an obligation to negotiate in good faith, especially where a party has been led into belief of prospective success. This argument has been accepted in the majority of civil law countries but *

German courts impose civil liability for breach of the precontractual duty of good faith and fair dealing, care and loyalty (culpa in contrahendo). The doctrine of culpa in contrahendo can be traced back to the 1861 article by a German jurist, Jhering. He suggested that liability for damages arises not only out of a breach of contract or a tortuous act or omission, but can also result from the breach of a precontractual duty of care, loyalty or good faith. He, thus, propounded the theory that parties to precontractual negotiations are contractually bound to observe the necessary diligentia (culpa in contrahendo). A breach raises a liability in reliance damages. Though this was primarily concerned with contracts concluded by mistake, it was used as a basis for precontractual liability in Bundesgerichtshof.

"A fault in contractual negotiations that renders one liable for damages can also exist in that one party awakes in the other confidence in the imminent coming into existence of a contract subsequently not concluded and this causes the latter party to incur expenses." *

Without the assumption of such a precontractual duty, Jhering argued, parties having the intention to enter into a contract "would run the risk of becoming the victim of the other party's carelessness". He limited the effusive implications of his proposition by acknowledging a precontractual liability only in two situations. First, where the principal contract ultimately comes into being or, second, where contractual negotiations have proceeded to the point at which acceptance is manifested. The courts have altered and extended the limitations. Thus, precontractual liability may exist independent of and separate from a principal contractual relationship between the parties. Though the emerging hypothesis of precontractual liability has developed into an extensive scheme of liability, the doctrinal classification remains quite far from uniform settlement. The doctrine of culpa in contrahendo extends to situations in which one party, prior to final agreement, breaks off contractual negotiations without reasonable grounds. If the party has negligently or fraudulently created the expectation on the part of the other party that a contract would be forthcoming, (although he knows or should have known that the expectation could not be realised) he is liable for damages.

Similarly, in 1907, a French scholar, Raymond Saleilles, advanced the view that after parties have entered into negotiations, they must act in good faith. Thus, neither can break off the negotiations arbitrarily without compensating the other for reliance damages. Under French case law., withdrawing from negotiations where the other party could reasonably expect the contract to be concluded, will be considered to be at variance with good faith. Liability is however not imposed for breach of a contractual obligation but on a theory of tort (responsabilite precontractuelle) with the wrong known as abus de droit (an abuse of right).

English courts regard this concept with suspicion probably because of their classical view of negotiations. English lawyers would as a matter of course, state that parties to a negotiation do not owe each other a duty of good faith. English courts would also resist implying a duty of good faith into the performance of commercial contracts negotiated at arm's length. This may still be considered the orthodox position of English law. However, the literature of English law has begun to consider much more carefully whether there might not be sufficient merit in explicitly recognising the advantages of imposing good faith duties on negotiations and performance. This is reinforced by the fact that other common law jurisdictions, have already started moving in this direction. In Canada, apparently, this concept is being moved under the
cover of the fiduciary concept. In Lac's case, La Forest J. stated that deterrence of conduct which is a breach of accepted business morality and of bargaining in good faith protects the expectations of the parties. 43

The concept has also not been enthusiastically accepted by U.S. courts. The formulation on a general duty of good faith in the Uniform Commercial Code and the Restatement (Second) of Contracts does not extend to negotiations.

However, in Arcadian Phosphates Inc. v. Arcadian Corp., 44 the court recognised that in the preliminary agreement, there may be an obligation to negotiate in good faith. Here, it was stated that the parties can bind themselves to a concededly incomplete agreement. This is in the sense that they accept a mutual commitment to negotiate together in good faith in an effort to reach final agreement within the scope that has been settled in the preliminary agreement. This case, if applied, could be an evolutionary advance. 45

Under Islamic law, the Quran and the traditions of the Prophet impose a duty to negotiate in good faith. The Quran refers to good faith, justice and honesty (ihsan) as imperative prerequisites in all Muslim transactions. 46 Some modern Arab laws extend the principle that a contract is concluded in the expectation that the obligor will fulfill his promise in good faith to precontractual agreements. 47 Under Egyptian law, negotiating parties owe one another a general duty of good faith and a duty of cooperation. 48

The recognition of good faith may have a double edged sword effect on international investment. There is really no reason to believe that its imposition would improve the regime under which negotiations take place. It might even have an undesirable chilling effect of discouraging parties if chances of success of such negotiations are slight. It might, alternatively, have an accelerating effect, increasing the pressure on parties to come to a hasty conclusion. 49 It is desirable, however, that parties are prevented from acting against accepted business morality and from acting in bad faith. 50

20 Atiyah states that it is impossible to assume that the concept of contract, today, can be said to exist outside the law, and that the law merely regulates this pre-existing phenomenon. Only with the aid of the law itself can we determine what contract law is about, and what a contract is. See Atiyah, P.S., n. 10 above, p. 1.
21 For cooperative activity, one finds a number of core features - consent, reliance, reciprocity, etc.
22 cf. Atiyah, P.S., n. 10 above, p. 5.
23 ibid., p. 9.
27 This is because none of the various national legal systems offers a specific set of rules according to which the legal implications of a letter of intent could be easily and clearly determined.
29 Similar considerations apply to other identical precontractual agreements, for instance, letters of comfort, memoranda of agreement or understanding, etc.
34 The statement that the parties "intended" to enter into an agreement may be relevant but will not necessarily be determinative.
35 Two classifications of such activities have been recognized-conduct in accordance with the content of the letter of intent and statements to third parties.
36 It is not essential that a letter of intent be signed for it to be binding.
37 Sperling, J., n. 30 above, pp. 407-408.
38 In Germany, careful distinction is made between letters of intent and option agreements which have gained considerable significance in practice.
Kensicher, H., n. 15, above, p. 2 13. One always has to bear in mind that civil law judges have a lot of discretion and decisions are reached on a case by case basis.

[1984] 1 All E.R. 504.


MacBryde, W. W., n. 13 below, p. 33.

U.S.C.A. Sixth Circuit, 1976 (541 F.2d 584). In this case, the document was captioned "Memorandum of Intent" and had been signed by both parties. The District Court determined that the six paged document was not a contract because it evidenced the intent of the parties not to be contractually bound. The Court of Appeal reversed the decision.

248 A.2d 625 (Del. 1965). Here, the last sentence of the letter of intent stated, "if the parties fail to agree upon and execute such a contract, they shall be under no further obligations to one another". The District Court decided, based on this sentence, that there was no intent to be bound. However, the Delaware Supreme Court considering the entire document and other evidence submitted by the plaintiff, reversed, stating that: "If there is evidence which, if accepted by the friar of fact, would support the conclusion that ... Itek & Co. intended to be bound ... There is also evidence that subsequently ... CAI failed to negotiate in good faith and to make 'every reasonable effort' to agree upon a formal contract as it was required to do."

According to the Court, the introduction of extrinsic evidence does not violate the parol evidence rule because that rule applies only after an integrated or a partially integrated agreement has been found.


Referring Principles:

- IV.8.1 - Principle of pre-contractual liability
- IX.1 - Basic rule