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"Bona Fides" Principle's Value in Pre-Contractual Liability

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Abstract

"Bona Fides" is a well known principle, internationally important as is being set in national laws and international treaties and convections. Dating from Roman law, this principle is used nowadays specially in contract laws by determining honest and fair behavior and lack of bad faith between the parties. Although the Albanian Civil Code provides no definition about good faith, requires it in pre - contractual phase. This paper aims to analyze pre - contractual phase, in all constituent elements provided by the Albanian legislation and the way the parties should behave with each other, without causing damages, showing the required good faith. The pre - contractual responsibility shall be determined by reference to the observance and implementation of "Bona Fides" Principle. The paper will treat the forms of good faith and the difficulties in understanding the existence or the lack of good faith being necessary to treat each case as unique. This paper will be realized by using doctrinal definitions, interpreting court cases and foreign legislation.

Keywords: *good faith, parties, pre contractual, damage, contract*

1. "Bona Fides" Becoming a Principle

Roman law is an extraordinary product of ancient times, created over centuries. Groups of specialists trained in law, scholars and jurists gave opinions over law by interpreting it, but the most precious contribution in law was *Corpus Iuris Civilis* initiated by Justinian I, Easter Roman Emperor and realized by a commission of jurists, who compiled all existing Roman law into one body. Rich of legal material and formulas, rules and principles it become an important source to all latter Western law systems.

During the second and early third centuries BC, Roman Society thought it necessary to allow certain claims based on contracts of sale, hire and service to be upheld by the legal system. The principle adopted (*iudicia bonae fidae*) added an element to *iudicia stricti iuris* which enabled a court to take into account circumstances, defences and considerations of fairness which otherwise have been excluded. The purpose of it was to free magistrates from the strict formalism of the *legis actiones* and allow them to accord a *iudicium* with a formula which directed judges to deliver judgment, not according to strict statutory law but according to the principle of contractual faith. (Pettinelli, 2005)

After the fall of Rome, the concept of good faith as an implied principle in the performance of contracts appeared again in mercantile practice during the eleventh and twelfth centuries and was adopted generally throughout civil law regimes. Civil law regimes take an expansive approach to the obligation of good faith applying it to both the formation of a contract and its performance. (Tetley, 2004)

From the 12th century onwards, contracts of good faith as they had existed under Roman law became the rule rather than the exception. A contract was concluded by the mere exchange of consent. However the passage from the principle of ex nudo pacto action non nascitur ("no right of action is created from a bare pact") to that of consesu obligat ("consent alone suffices") occurred gradually, and apparently with great difficulty. It appears as if consensualism was only recognized as a general principle in the 16th century. It is equally during the course of this period that good faith became a general principle of both national and international commerce. This time period also saw the generalization of the principle exceptio doli, which would later become the foundation for the theory of abuse of right. ("European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules", 2008)

The French Civil Code 1804, which affected most of modern codes in Civil law system, included "bona fides" principle to contracts.

Most European civil codes contain a general good faith provision. (Hessenlink, 2004)

2. The Meaning and the Forms of "Bona Fides" Principle

Bona Fides is required as a condition for good relations between people at all times. Being honest, correct and loyal in a relationship is a behaviour preferred and promoted by moral, good habits and religion. It seems easy to understand bona fides as a sincere intention to deal fairly with the others and in everyday life we estimate people who behave in this way. But as a legal principle, bona fides is hard to assess.

Good Faith as a principle of contract law has long escaped precise definition. This is largely due to the fact that the concept is generally applied as a basis to rectify the perceived unfairness of a strict legal result under the applicable contract law. As a result, the concept of good faith has many meanings in a variety of circumstances. Because the legal concept of good faith is based upon the moral concept of fairness, it is by nature nearly impossible to define because standards of fairness naturally vary depending upon one's perspective. Even among philosophers, defining the moral principle of fairness been difficult. (Barnes 2006)

Good faith is often said to be in some way connected with moral standards. On the one hand, it is said to be a moral standard itself, a legal- ethical principle; good faith means honesty, candour, loyalty et cetera. It is often said that the standard of good faith basically means that a party should take the interest of the other party into account. On the other hand, good faith is said to be the gateway through which moral values enter the law. (Hessenlink, 2004)

The term "good faith" has thus given rise to several strands with respect to its meaning. Firstly, it could be considered a duty to act fairly and equitably towards the other party. Secondly, it could be a duty and issue of trust and confidence between the parties involved. Thirdly, it might see the establishment of a set of standards of reasonable behaviour in contractual relations and finally, it could be defined by a set of examples of "bad faith". Therefore, according to different cultures, jurisdictions, functions and scopes the term is nowadays differently associated. (Pettinelli, 2005)

Bona Fides is required by the Albanian legislation that provides in every case "privileged position" of persons or parties who enter into a legal relationship in good faith. They are "protected" by the law precisely for this fact. But the Albanian legislation does not provide a definition about good faith.

> *"A party's state of mind in acting or carrying out an action or transaction, evincing honesty, fairness, full communication of any hidden issues or information, and an absence of intent to harm other individuals or parties to the transaction." (Law Dictionary)*

According to that definition I think that we should have more than a philosopher to get the meaning of honesty and fairness. More difficult seems to explain "the state of mind" or "the absence of intent to harm". The judge's role would be difficult and each case will have to be seen as unique.

Arguably a definition of good faith is not needed in order to understand and apply such a concept if we reflect that: ***[a] study not of contract law, but rather of contract practice is the key to understanding the economic properties of contracting that are necessary to work out sensible uniform laws for commercial purposes.*** The suggestion here is that an initial understanding of good faith is derived from a study of what judges, jurists and legislators have referred to as being examples of good faith. The core principles of good faith can then be extracted from this stock of knowledge. (Bruno, 2003)

As is well known good faith can be seen under the double aspect of subjective good faith and objective good faith. The first is to be considered as a conduct by a person in ignorance to undermine the others situation legally protected. (Pilot, 2006) Subjective good faith is usually defined as a subjective state of mind: not knowing nor having to know of a certain fact or event. (Hessenlink, 2004) The objective good faith conctretized in the obligation imposed to the potential contractor of the legal transaction in progress, to keep a certain behaviour characterized by fairness, so as not to prejudice the interest that counterparty has at the valid conclusion of the legal transaction. (Pilot, 2006)

3. Pre-Contractual Liability

In this part of the paper I will try to explain the pre-contractual phase and the liability of the parties, that in the best of the cases will bind the contract, but it can happen that the negotiations break off.

> *"The contract is considered concluded when the parties have shown their mutual willingness, being agreed for all its essential terms." (The Albanian Civil Code: Article 674 paragraph I)*

According to Prof. Mariana Semini (1998) the conclusion of the contract passes necessarily in two stages. It is necessary for one party to turn to the other party with who requires concluding a contract and this represents the first

stage that is the offer. The offer is distinguished from preliminary discussions, offers made in jest or promotions. The second stage that represents the conclusion of the contract is related to the willingness of the other party to accept the offer. The offer and the acceptance, both must meet certain conditions to be considered valid and to lead to the desired consequences. Among the theories about the moment of the conclusion of the contract, the Albanian legislation acknowledges the moment of the arrival of acceptance to the offeror.

The pre-contractual phase is developed until the acceptance of the offer and the conclusion of the contract.

The pre-contractual era is notoriously difficult to characterise: the parties have been introduced; no contract has been formed. A contract is not guaranteed but it is the ultimate goal. Negotiations may collapse, piece by piece or suddenly. (C. von Bar, Clive & Schulte-Nolke, Beale, Herre, Huet et al. 2009)

The intention of the parties through the negotiations, is to reach the conclusion of the contract with favourable conditions. During this phase they invest time and they try to achieve the final goal. In fact negotiating means to consider a serious offer and then to decide either to accept or reject it, or to make a counter offer and to extend the negotiation.

This is a delicate phase and quite uncertain, especially if "the freedom of negotiation" principle "makes the parties believe" that they can change their mind, without having any consequences. The potential damage in the pre-contractual phase, recognizes the obligation to be rewarded, even that the pre-contractual is not considered as contractual relationship.

"Parties during the course of negotiations for the drafting of the contract must act in good faith towards each other" (The Albanian Civil Code article 674 paragraph I)

Although it is not yet a contractual relationship, it is required a behaviour specified "in good faith" from the parties, in order to avoid possible damages. This is called pre-contractual liability deriving from a harmful conduct during the formation of the contract. Certainly the party that has suffered any damage can seek to be compensated if has suffered damages as a result of lack of good faith from the other party.

"The party, who knew or had to know the reason of the invalidity of the contract and has not let the other party know that, is obliged to compensate the damage that the latter has suffered because believed without fault in the validity of the contract." (The Albanian Civil Code article 674 paragraph II)

According to The Albanian Civil Code, article 675 "In case that a contracting party possesses professional knowledge and evokes the other side of her full confidence, it has an obligation to provide information and guidance in good faith." In that case the information should remain confidential if damages the party that has given it. In specific contracts like franchising, the obligation of confidentiality is expressed clearly and is worth even if the contract is not concluded. The violation of this duty is followed by the obligation to compensate the damage. (The Albanian Civil Code article 1058)

So, the pre-contractual phase carries the possibility of liability for the party which acts in lack of good faith. The doctrine recognizes it as "culpa in contrahendo", referred to Jhering who suggested, the law can ill afford to deny the innocent party recovery altogether; it has to provide for the restoration of the status quo by giving the injured party his "negative interest" or reliance damages. The careless promisor has only himself to blame when he has created for the other party the false appearance of a binding obligation. Of course, the party who has relied on the validity of the contract to his injury will not be able to recover the value of the promised performance, the expectation interest. (Kessler, Friedrich and Fine, Edith, 1964)

But Bona Fide Principle should be evaluated carefully. The incorrect application of it leads to unfair benefits and unnecessary legal protection.

Referring to Prof. Ardian Nuni (2004) "Bona Fide" does not mean an absolute value of appearance, but protection of good faith. Good faith does not mean total ignorance, and the faith is not blind. It is protected only the third who has been intelligent in information. In case of private legal relations, especially considering the third person's interest, the naive faith is not enough, but there is also a task of intelligence that imposes the provide of what meant to say the declarant. Both parties should know what they are contracting and should also understand the content and evaluate all the complex circumstances that form the content. The negligent lack to inform or be informed is attacked by law. So if the party that should know the meaning of the content or the circumstances of the content of the other party is indifferent, the effective recognition has not happened by its fault.

An interesting comparison to make here may be to the Dutch system where the Supreme Court has artificially chopped pre-contract negotiations into three component stages, each attracting different liabilities. At the preliminary enquiry stage there is no liability for parties breaking off negotiations. During substantive negotiations parties are entitled

to terminate but must compensate the other party. Nearing the conclusion of the pre-contractual stage this availability disappears, being replaced by performance damages, or even an order to continue negotiations. (C. von Bar, Clive & Schulte-Nolke, Beale, Herre, Huet et al. 2009)

4. Applying "Bona Fides" Principle

While browsing the Italian Civil Code the good faith is often mentioned, especially by the provisions related to contracts (articles 1337, 1366, 1375, and 1460). The provision about the existence of good faith in pre-contractual phase is required as an obligation. (The Italian Civil Code article 1337)

In the Republic of Germany, contractual obligations are subject to the standard of good faith.

> *"The debtor is bound to effect performance according to the requirements of good faith, giving consideration to common usage." (The German Civil Code article 242)*

The provision had a profound effect on the development of German contract law by the courts who created a number of obligations to ensure a loyal performance of a contract such as a duty of the parties to cooperate, to protect each other's interests and to give information. (Pettinelli, 2005)

The French Civil Code recognizes good faith as "a must" in performing a contract.

> *"Agreements lawfully entered into take the place of the law for those who have made them.*
> *They may be revoked only by mutual consent, or for causes authorized by law.*
> *They must be performed in good faith." (The French Civil Code article 1134)*

According to Musy (2000) the good faith principle is applied by scholars in the formation of contract "the parties must deal in good faith"; the freedom of contract principle, thus, is limited by the good faith principle.

In the Civil Law system, the minimalist view is represented by the French courts, who have not relied on the *bonne foi* to the same extent that their German and Italian counterparts did. An even more minimalist approach is represented by the common law of England does not recognize any general obligation of the parties to a contract to conform to the standard of good faith. (Musy 2000) To ascertain the presence, function or even scope of a good faith principle it must be noted that, unlike the above discussed civil law systems and few common law jurisdictions such as the United States, there is no general clause or general principle of good faith which applies, even for a particular area of English law. (Pettinelli, 2005) Historically, the common law of England did not recognize good faith. (Tetley, 2004)

As long as a precise definition for bona fide is not given by law and according to the fact that bona fide is closely linked to loyalty, fairness and correctness, I think it is necessary to assess each case and the particular role of the judge is indispensable in interpreting the presence or not of good faith.

To concretize good faith is required an objective position from the judge.

Though the French courts have not given the notion of *bonne foi* the same importance as the German courts, similar results were obtained by the application of a general theory of *abus de droit* which was developed at the end of the 19th century and was based on good faith. (Pettinelli, 2005) The doctrine of abuse of rights is closely connected to the principle of good faith. Such an abuse is deemed to occur when a party exercises a right in such a manner that its benefit and the counterparty's loss or burden are unjustifiably disproportionate. A party that abuses its rights is deemed to have acted in bad faith and to have exceeded the powers and legitimate interests protected by the law. Therefore, such a party may be estopped from exercising its right and may also be liable for damages. (Coppola, Traverso, 2010)

According to Hesselink (2004) in most systems, particularly in Germany, scholars have developed methods for rationalising and objectivating the decisions of the court. The purpose is to render the application of the law in general, and of general clauses like good faith in particular, as rational and objective (and thereby predictable) as possible, instead of leaving it to the subjective judgment of the individual judge. The generally agreed method for rationalising is that of distinguishing functions and developing groups of cases in which good faith has previously been applied. In doing so legal doctrine has developed an 'inner system' of good faith, which is regarded as the content of that norm. It should be added that the process of concretisation has not been totally identical in all countries.

In Italy the Supreme Court (Corte Suprema di Cassazione) has expressed in September 2009 (Decision No. 20106, 18.09.2009) that the principle of objective good faith, as the mutual loyalty of conduct, should govern the formation, executation and interpretation of the contract and accompanies it at every stage. (Francesca Picierno 2009) The court further noted that the principle of good faith is an instrument that the judge must apply in order to review contractual provisions - and modify and supplement them if necessary - so as to ensure that the parties' interests are

fairly balanced. (Coppola, Traverso, 2010) The Supreme Court held that a judge must always monitor and interpret the parties' actions, taking account of their respective positions and determining whether either party has unduly exploited its stronger position - or its counterparty's weaker position - to achieve its goals. Thus, a judge must interpret the parties' conduct in order to ensure that the parties' contrasting interests are balanced. (Coppola, Traverso, 2010)

5. Conclusions

Good faith is an important principle that does effect or operate not only in the field of contractual relations, but even in family law (The Albanian Family Code articles 60, 262), labour law (The Albanian Labor Code *article* 153) and property law (The Albanian Civil Code *articles* 166, 167, 168, 175, 297, 299, 301, 306, 309).

Bona Fides Principle is provided by domestic law and even by international law. It is one of the fundamental ideas underlying the Principles of UNIDROIT (2010) that set forth general rules which are basically conceived for international commercial contracts. According to Article 1.7 *"Each party must act in accordance with good faith and fair dealing in international trade. The parties may not exclude or limit this duty".*

Earlier good faith is mentioned by the United Nations Convention on Contracts for the International Sale of Goods (2010) which adopts uniform rules which govern contracts for the international sale of goods contributes to the removal of legal barriers in international trade.

> *"In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade." (United Nations Convention on Contracts for the International Sale of Goods (1980) article 7 paragraph I)*

The pre-contractual phase that leads to the conclusion of the contract should be traversed by Bona Fides principle. Pre-contractual liability means that in case of lack of good faith, possible damages should be compensated.

Although it is a little hard to understand and verify the existence or the lack of good faith, it is necessary to rely in standards of good faith, in order to protect the parties during the pre-contractual phase and during the performance of it.

Once parties enter into negotiations for a contract, the sweeping language of the cases informs us, a relationship of trust and confidence comes into existence, irrespective of whether they succeed or fail. Thus, protection is accorded against blameworthy conduct which prevents the consummation of a contract. A party is liable for negligently creating the expectation that a contract would be forthcoming although he knows or should know that the expectation cannot be realized." Furthermore, the parties are bound to take such precautionary measures as are necessary for the protection of each other's person or property. (Kessler, Friedrich and Fine, Edith, 1964)

It is said that in some systems good faith is regarded- and actually used by the courts - as a means through which the values of the Constitution enter into private law. (Hessenlink, 2004) The lack of a definition by the civil codes and considering good faith more as a moral or ethic norm than a legal norm, makes the objective interpretation role of the judge, indispensable, "breaking" the belief that in civil law system the judge applies the law and does not create it. The judge has to decide and treat each case as unique, evaluating the circumstances of each case.

It may be that not all the facts mentioned in the rule have occurred, but some others have, which he regards as equivalent, so that he finds it suitable that the same legal effect should follow in this case or it may occur that all the facts mentioned in the rule have indeed occurred, but also some other facts which, in the eyes of the judge, mean that the legal effect indicated in the rule should not follow. (Hessenlink, 2004)

According to Herbert Roth (cited by Hessenlink, 2004) good faith is not the highest norm of contract law or even of private law, but no norm at all, and is merely the mouthpiece through which new rules speak, or the cradle where new rules are born. What the judge really does when he applies good faith is to create new rules. These new rules are concretisations, supplementations and corrections to the rules and system of the code.

By interpreting legal norms the judge becomes more creative and less strict.

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