Article

The Legal Status of Pre-Contractual Liability: Contrasting Responses from German and English Law

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ABSTRACT

China has begun a legislative process for its civil code. This thesis focuses on how to shape the pre-contractual liability in the forthcoming Chinese Civil Code from a comparative perspective. In devising the pre-contractual liability, the legislators of China confront a long-running controversy in Chinese Law- the legal status of pre-contractual liability. More precisely, whether the principle of good faith can directly open up liabilities in the pre-contractual phase and whether the pre-contractual liability is independent from the law of tort. The comparative study of this thesis builds a picture of the contrasting responses provided by German and English Law to the questions faced by Chinese legislators. The contrasts between two extraordinary systems serve as a basis of finding solutions to those controversies in Chinese Law. This article at the end offers a proposal to the codification of the Chinese Civil Code.

Keywords: *Pre-Contractual Liability, Good Faith, Duty of Care, Control Mechanism, The Law of Tort*

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CONTENTS

I. INTRODUCTION

Pre-contractual liability[1] has been the highlight of the study of comparative private law,[2] both for the remarkable variation across approaches taken by different jurisdictions and its inconclusive legal status. The aim of this thesis is to examine how pre-contractual liability should be shaped in the forthcoming Chinese Civil Code.[3]

Legislators of the Chinese Civil Code will face mainly two connected controversies in devising the regime of pre-contractual liability, which would also serve as the research questions addressed by this thesis. The most fundamental concerns the position of the principle of good faith in the pre-contractual phase, particularly with regards to whether the negotiating parties should assume a duty to negotiate in good faith. Next, it seems that the majority of scholars seek to copy *culpa in contrahendo* in order to establish independent pre-contractual liability--however, many scholars still explicitly object to this proposition. Furthermore, a recent debate derived from this issue is whether to the nature of liability in articles 42 and 43 of the CCL can be characterized as pre-contractual liability or tortious liability.[4]

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1. The language used varies. Pre-contractual liability may be known as *culpa in contrahendo* [fault in negotiation], liability in the pre-contractual phase or liability during negotiation. Normally, it refers to the pre-contractual regimes or the position taken towards the pre-contractual phase in jurisprudence where there exists no codified scheme for pre-contractual liability as in the U.K., France or Netherlands.

2. The issue of pre-contractual liability has been significant in comparative private law, especially in research concerning possible EU harmonization. For the pre-contractual liability project as a part of the European common core project, *see* PRE-CONTRACTUAL LIABILITY IN EUROPEAN PRIVATE LAW 12-17 (John Cartwright & Martijn Hesselink eds., 2008).

3. In October 2014, Chinese authorities decided to compile the Chinese Civil Code. In December 19, 2016, the draft of the general rules (first part) of the civil code was submitted to the session of Chinese top legislature for its third reading. Related news, *see Top Legislator Calls for Civil Code with Chinese Characteristics,* NAT'L PEOPLE'S CONGRESS CHINA (Oct. 12, 2016), http://www.npc.gov.cn/englishnpc/news/Legislation/2016-10/12/content_1998952.htm; *Civil Code Principles Submitted to Legislature*, CCTV.COM (June 30, 2016), http://english.cctv.com/2016/06/30/VIDEY3jMbtMJU8M8zDZjHucx160630.shtml and *China Begins Legislative Process for Civil Code*, CCTV.COM (June 28, 2016), http://www.ecns.cn/2016/06-28/215905.shtml.

4. The current Chinese pre-contractual regime, in particular articles 42 and 43 of the Chinese Contract Law (CCL), which is similar to the approach taken by the UNIDROIT Principles of International Commercial Contracts (PICC) and the Principles of European Contract Law (PECL). Inspired by *culpa in contrahendo* in German Law, many scholars argue that these two features of the CCL establish an independent institution of pre-contractual liability in China.

Article 42 states: "[W]here in the course of pre-contractual negotiation, a party engaged in any of the following forms of conduct, thereby causing loss to the other party, he shall be liable for damages: (1) Negotiating in bad faith under the pretext of concluding a contract; (2) Intentionally concealing a material fact relating to the conclusion of the contract or supplying false information; (3) Any other forms of conduct which violate the principle of good faith." And article 43 states: "[N]egotiating parties shall not disclose or improperly use any business secrets they become aware of in negotiations, regardless of whether the contract has been concluded or not. Otherwise, the party in breach of confidence shall be liable for the losses of the other party."

The impact of this controversy in practice is that judges tend not to apply tort law in the pre-contractual phase even where the case cannot be covered by articles 42 and 43 of CCL, such as careless misrepresentation.[5]

For the purpose of discussion, this thesis will focus mainly on the approach taken by two foreign systems as representatives of the Civil Law and Common Law jurisdictions--namely, the German and English legal systems. Those two systems present a useful contrast in approaches to these issues and a basis for exploring a possible means of addressing these controversies. Where appropriate, this thesis will as well refer to the PICC and proposals for possible EU harmonization namely, the PECL, the Principles of the Existing EC Contract Law (Acquis Principles, ACQP) and the academic Draft Common Frame for Reference (DCFR).

The significance of undertaking a comparative study between those two systems is even more so given the legislative orientation of China--i.e. diversified transplantation--which indicates the ambition of Chinese lawmakers to combine the merits of both Civil Law and Common Law.[6]

At the end of this thesis, a conclusion will be drawn in response to those long-standing controversies, and proposals will be offered as to how the pre-contractual liability should be dealt with in the forthcoming Chinese Civil Code.

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5. Professor Lining Wang held that there were three main advantages for an independent institution of pre-contractual liability: firstly, advocating commercial ethics and preserving economic order; secondly, granting sufficient redresses to the suffering parties; thirdly, filling the lacunae of the law of obligations. *See* WANG LI-MING (王利明), HETONGFA YANJIU (合同法研究) [THE RESEARCH ON CONTRACT LAW] 316-17 (2002). For the same opinion, *see* WANG TZE-CHIAN (王澤鑑), ZHAIFA YUANLI (債法原理) [THE THEORY OF THE LAW OF OBLIGATIONS] 41-45 (2001); CUI JIAN-YUAN (崔建遠), HE TONG FA (合同法) [CONTRACT LAW] 35 (2012); Han Shi-Yuan, *Culpa in Contrahendo in Chinese Contract Law*, 6 TSINGHUA CHINA L. REV. 157, 158 (2014). The main objection is that the pre-contractual liability in China essentially is a tortious liability, *see* Yu Fei (于飛), *Woguo Hetongfa Shang Diyueguoshi Zeren Xingzhi De Zai Renshi* (*我國合同法上締約過失責任性質的再認識*) [*Reconsideration on the Nature of Neglect of Duty in Contract Making by Contract Law in China*], 5 ZHONGGUO ZHENGFA DAXUE XUEBAO (中國政法大學學報) [J. CHINA U. POL. SCI. & L.] 92, 92-98 (2014); Zhang Jin-Hai (張金海), *Yelinshi Diyue Guoshi Zeren De Zai Dingwei* (*耶林式締約過失責任的再定位*) [*Relocation of Jhering's Culpa in Contrahendo*], 6 ZHENGZHI YU FALU (政治與法律) [POL. SCI. & L.] 6, 107 (2010).

6. Peng Zhen (彭真), the former Chairman of the Standing Committee of the National People's Congress emphasized during the legislation of General Principles of Civil Law in 1986, the early stage of Chinese economic reform, emphasized that: "Foreign experiences, no matter from Socialist or Capitalist Countries, from common law or civil law countries, should be referred to and borrowed by us in consideration of our tradition". At that time, his speech was relatively enlightening for breaking the shackles of ideology and politics in both legislation and legal research. His opinion has been officially recognized as the principle of Chinese legislation. English translation of his speech, *see* Han Shi-Yuan, *A Snapshot of Chinese Contract Law from an Historical and Comparative Perspective*, *in* TOWARDS A CHINESE CIVIL CODE: COMPARATIVE AND HISTORICAL PERSPECTIVES 244-45 (Lei Chen & C.H. (Remco) van Rhee eds., 2012).

II. THE GENERAL COMPARATIVE APPROACH

A. *Introduction*

The comparative study in this thesis will build a picture of the contrasting responses provided by German and English Law to the research questions of this thesis in the pre-contractual context: the position of good faith, the role of tort and the allocation of risks, in order to provide inspiration for the improvement of Chinese Law. A brief introduction to the approach taken by Germany and England will now be given, which lays the foundation for the detailed comparison and arguments about the legal status of pre-contractual liability later on.

B. *German Approach: Culpa in Contrahendo*

In German Law, the doctrine of *culpa in contrahendo* was devised as the basis of independent pre-contractual liability. Over the past 150 years, the judicial and theoretical construction of *culpa in contrahendo* has developed to give it a much wider and deeper scope compared with the original concept.[7] In 2002, as a result of German reform of the law of obligation, *culpa in contrahendo* was blended into the German Civil Code (BGB), in article 311(2).

Culpa in contrahendo is regarded as one of the most characteristic inventions in German civil law. Though it can be traced back to Roman law and general state laws for the Prussian states in 1794, the explicit expression of this concept was first put forward by Rudolf von Jhering, in his article "*Culpa in contrahendo-Damages for not-concluded and non-perfect contract*" *(Culpa in contrahendo-oder Schadensersatz bei nichtigen oder nicht zur Perfection gelangten Verträgen)* in 1861.[8]

Culpa in contrahendo literally means "fault in contracting" and when applied in German Law, it implies the duty to act in good faith or the duty to take reasonable care in favour of the other party in pre-contractual negotiations, which means that the fault in this sense is wider than its normal sense- intent and negligence in the law of tort. Losses of reliance interests, including the wasted expenditures for negotiation and the necessary preparation for performance, shall be recoverable against the party whose blameworthy conduct during negotiations brought about the invalidity of

7. DIETER MEDICUS, SCHULDRECHT I: ALLGEMEINER TEIL 61 (2004).

8. Rudolf von Jhering, *Culpa in contrahendo: oder Schadensersatz bei nichtigen oder nicht zur Perfection gelangten Verträgen*, *in* JAHRBÜCHER FÜR DIE DOGMATIK DES HEUTIGEN RÖMISCHEN UND DEUTSCHEN PRIVATRECHTS BD. 4, 1, 1-112 (1861). For a discussion in English, *see* Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 401-49 (1964). In Chinese, *see* Zhang, *supra* note 5, at 99.

contract or prevented its perfection, but not exceed the expected interests the hoped-for contract would bring if it were concluded.

Though the codification of *culpa in contrahendo* was not a major priority in Germany, the German reform and modernization of the law of obligations in 2002[9] still provided an answer to the controversy through the integration of the new general rule of *culpa in contrahendo*, article 311(2), in the BGB. The new article has made a significant impact yet it still adopts a German style *i.e.* abstract, systematic and general, meaning that it is extremely hard to interpret and apply the article without a solid systematic understanding of the shape of judicial and theoretical construction.

The revised BGB has resulted in significant change, bringing about a conclusion to the controversy.[10] It neither identifies *culpa in contrahendo* as an independent cause of obligation parallel with contract, tort, voluntary agency and unjust enrichment, nor does it go back to the path of torts. It has achieved this through five major revisions which are related to pre-contractual issues.[11]

The first revision is in the first section of the law of obligations, § 241(2). It codifies and confirms the legal status of protective duties, clearly stating that "[a]n obligation may also, depending on its contents, oblige each party to take account of the rights, legal interests and other interests of the other party". Since this new provision, protective duties have become statutory duties.

Secondly, it includes *culpa in contrahendo* as a general rule, § 311(2). In the frame of contracts (Division 3 Contractual Obligations) § 311(2) stipulates that in the following three circumstances, the protective duties outlined in § 241(2) would come into existence before the conclusion of contracts: the commencement of contractual negotiations; the initiation of a contract where one party, with regard to a potential contractual relationship, gives the other party the possibility of affecting his legal interests and other interests, or entrusts these to him; similar business contacts.

Thirdly, a unified damages provision, § 241(2) replaces the former category of non-performance. Before reform, there were three fixed types of non-performance in the BGB with different requirements of formation and legal consequences. These were the impossibility of performance, delay in performance and inadequate performance. The main problem of the old classification is that it was too complex, conceptual and practically unsound.

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9. The background of the German reform of the law of obligation, *see* REINHARD ZIMMERMANN, THE NEW GERMAN LAW OF OBLIGATIONS: HISTORICAL AND COMPARATIVE PERSPECTIVES 1 (2005).

10. *Id*. at 31.

11. Mathias Reimann, *The Good, the Bad, and the Ugly: The Reform of the German Law of Obligations*, 83 TUL. L. REV. 877, 888-90 (2009).

It was a highly artificial concept of impossibility of Pandectist vintage.[12] Inspired by the CISG, PECL and PICC, a uniform concept of breach of duty (Pflichtverletzung) has been accepted by the BGB in § 241(2): "If the obligor breaches a duty arising from the obligation, the obligee may demand damages for the damage caused thereby".[13] The new system places the emphasis on granting a remedy but not on imposing liability with the single track "breach of duty- damages".

In summary, the reforms affirm the existence of protective duties in the pre-contractual period. By virtue of a single track of "breach of duty", violation of all protective duties would invoke damages in the unified remedy system. In other words, *culpa in contrahendo* has been absolutely brought into the effects of the contracts.

C. *English Approach: Particular Liabilities Arising During Negotiations*

English law does not have a developed scheme for pre-contractual liability. There is no such strongly perceived unity to the so-called pre-contractual liability. The approach of English Law to the duty between negotiating parties is restrictive. As Professor John Cartwright states:

> [D]uring negotiations the parties do not owe each other any general duties which arise by virtue of the negotiations themselves-whether at the outset or even when the negotiations have lasted for a protracted time or have apparently almost reached their conclusion.[14]

There is no concept of a duty of good faith, loyalty or co-operation between negotiating parties in law. The agreement to negotiate is not enforceable in English courts, no matter adding good faith clause or using best endeavours. In a bargain at arm's length, in principle negotiating parties do not owe each other a duty of disclosure even where they know that the other party has made a serious mistake as to the subject-matter, as long the mistake is not incurred by him. One party's breaking-off negotiation does not constitute a tortious wrong even if he knows the other party would therefore suffer losses. There is no general liability based on estoppel. In a

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12. ZIMMERMANN, *supra* note 9, at 39.

13. For how CISG, PECL and PICC affect German reform of the law of obligations, *see* Hannes Rösler, *Hardship in German Codified Private Law: In Comparative Perspective to English, French and International Contract Law*, 15 EUR. REV. PRIV. L. 483, 502-05 (2007); Klaus Peter Berger, *The Principles of European Contract Law and the Concept of the "Creeping Codification" of Law*, 9 EUR. REV. PRIV. L. 21, 30-34 (2001).

14. JOHN CARTWRIGHT, CONTRACT LAW: AN INTRODUCTION TO THE ENGLISH LAW OF CONTRACT FOR THE CIVIL LAWYER 72 (2013).

word, English Law is reluctant to characterize pre-contractual negotiations as a legally-protected relationship for the reason that the negotiating parties are inherently adversarial or competitive.

A purely general approach would exaggerate the differences between English Law and German Law. The rejection of a general duty does not mean there would be no liability at all in the pre-contractual phase. English Law prefers to find a particular reason other than the relationship of negotiation itself for imposing liability, given the reluctance to work from general principle. The party making the misrepresentation upon which the other party relies could be held liable in the law of tort. The unjust enrichment may be invoked to grant one party the reimbursement of his pre-contractual expenditures if the other party promises to do so or encourages the extra expenditures. English Law also has well established equitable rules relating to confidential information, applying to information disclosed by one negotiating party to another.

For the purpose of discussion, this thesis does not intend to examine in detail or to evaluate the peculiarities of the English approach. The real focus here is in identifying the merits of the English approach which could be drawn upon by Chinese Law.

III. THE CHARACTERIZATION OF PRE-CONTRACTUAL RELATIONSHIP

A. *Introduction*

The initial step for every jurisdiction in devising a regime of pre-contractual liability is to propose a preset model: what is the relationship they presuppose between the negotiating parties, how the negotiating parties are expected to act in that relationship and whether relationship is worth legally protecting. It is the variety of models of pre-contractual relationship that cause the considerably different characterizations in different jurisdictions.

Three types of characterization will be examined in this chapter-the adversarial relationship in English Law, the reliance relationship in *culpa in contrahendo* and the good faith relationship in the BGB and EU Law, ranging from loose to strict, and towards a protected relationship.

B. *English Law: Adversarial Relationship*

Contract is an instrument of business. While engaged in negotiations towards a prospective contract, English Law places negotiating parties in a purely monetary and business relationship, not involving social ethics, with two presuppositions. The first is that each party has certain basic business

qualities, such as the ability to make independent judgments, evaluate potential risks, de-risk and most significantly to take care of his own interests in a sensitive way. The second is that each party is a selfish *Homo economicus*, which is greatly influenced by the classical liberalism. In business ethics, selfishness itself is not blameworthy, as long as there is no deceit or careless representation.

In a free society, the role of law is to draw a bottom-line and everyone is free to pursue a high moral standard or behave in a way which barely meets the minimum. English Law declines to raise that baseline, due to its business-friendly ethos. In the negotiations for a contract, both parties bargain for the most favorable terms to maximize their own business interests. Either party would very likely and naturally break off negotiation if better considerations were provided elsewhere. Sometimes, both parties can make concessions to conclude a contract, but it is more common that the negotiation fails owing to dissatisfaction with the position they were in and the possibility of no compromise in a future contract. These choices are based on complex business factors, strategies and specific circumstances, which, by law, should not and could not be interfered with. Both parties ought to be free to behave in a self-interested way.

Negotiation is the battle for business interests, which was affirmed by The House of Lords in *Walford v. Miles*. That was put most strongly by Lord Ackner as:

> [T]he 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. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms.[15]

In the belief that the negotiating parties essentially are in an adversarial position, English Law declines to impose the duty to negotiate in good faith in the pre-contractual phase. Without special agreements or statutory provisions, there is as well no general duty of disclosure in pre-contractual negotiation, as Blackburn J. stated:

> [W]hatever may be the case in a court of morals, there is no legal

15. Walford v. Miles [1992] 2 AC 128 (HL) 138.

> obligation on the vendor to inform the purchaser that he is under a mistake, not induced by the act of the vendor.[16]

The reluctance in English Law to admit the duty of good faith in negotiations even extended to the rejection of an expressly agreed obligation to negotiate in good faith.[17] The main reasoning is that the duty of good faith is too subjective and uncertain, which will be discussed later.

Sometimes the adversarial relationship is too absolute to show the overall perspective of English Law in the characterization of pre-contractual phase owing to the complexities of negotiation as a business game- i.e. the combination of competition and cooperation. There are still many statutory limits for parties to act in a self-interested way especially in the circumstances that the negotiation is not at arm's length.

Without doubt, compared with a binding contract, the negotiation itself is a more vulnerable relationship and lacks the identity of interests. This is the root cause for limited liabilities in pre-contractual negotiation in English Law. The underlying business-friendly ethos, which pursues certainty and replaces general ethics with business ethics is the main advantage of the English approach.

C. *German Law: From Reliance to Good Faith*

German Law has always regarded negotiations as a form of friendly cooperation but experienced a shift of emphasis, from the protection of reliance to good faith, revealing the reinforcement of social ethics in characterizing the pre-contractual relationship.

1. *Negotiation as a Reliable Cooperation*

Before the reform of the law of obligations in 2002, *culpa in contrahendo* was established and developed by jurists, then reaffirmed by the case law. When *culpa in contrahendo* was first established, the protection of reliance on a declaration of intent (offer and acceptance, in contract) or a hoped-for contract put less emphasis on social ethics but highlighted

16. Smith v. Hughes [1871] LR 6 QB 597, 603-04. In the same case, Cockburn CJ stated: "[T]he question is not what a man of scrupulous morality or nice honour would do under such circumstances. The case put of the purchase of an estate, in which there is a mine under the surface, but the fact is unknown to the seller, is one in which a man of tender conscience or high honour would be unwilling to take advantage of the ignorance of the seller; but there can be no doubt that the contract for the sale of the estate would be binding", *Smith*, LR 6 QB 597 at 607.

17. John Cartwright, *Negotiation and Renegotiation: An English Perspective*, *in* REFORMING THE FRENCH LAW OF OBLIGATIONS: COMPARATIVE REFLECTIONS ON THE AVANT-PROJET DE RÉFORME DU DROIT DES OBLIGATIONS ET DE LA PRESCRIPTION ('THE AVANT-PROJET CATALA') 51, 65-66 (John Cartwright et al. eds., 2009).

indemnity in particular cases. The main purpose was to improve the stability and security of legal transactions to fit business development.[18] Besides this, only if the reliance is legitimate, can *culpa in contrahendo* be applied. Later on an acknowledgement of the significance of social ethics within the community has led to a recognition of the need to focus on reliance between members of social groups.

Jhering's reasoning of *culpa in contrahendo* was based on a reliable relationship of negotiating parties. In his reasoning, when pre-contractual negotiation begins the negotiating parties should act diligently to avoid the external risks which would negatively affect the binding force of the contract. The purpose of *culpa in contrahendo* in this sense is to prevent against the potential strained and adversarial relationship between negotiating parties owing to the fact that if in negotiation one party has to pay for the adverse consequences, especially if the contract was avoided or null and void, which can be attributed to the other party, the negotiation itself would be exposed to unknown risks at the very beginning.[19] Jhering's reasoning implies an emphasis on the protection of reliance on the other party and the security of transaction from a more general perspective.

The protection of reliance has been elevated to the level of social ethics. Only when reliance between members of a social group can be generally maintained and form the basis of complex interactions, is there a possibility to live peacefully in a comfortable community. Otherwise, everyone would stay in a potential state of hostility, which would correspondingly lead to a significant disruption of transactions.[20] When the elements of social ethics were further reinforced in German Law, *culpa in contrahendo* moved towards a protective relation on the basis of good faith and fair dealing.

2. *The Rise of Good Faith*

As mentioned in the last chapter, at the beginning, *culpa in contrahendo* was less involved with good faith, and was only a tool for remedy. As the principle of good faith rose to become the overriding principle in German civil law, the boundaries and definitions of *culpa in contrahendo* became gradually vaguer as it began to be implemented in varying situations with different emphasis.

The first erosion of the principle of good faith is the concept of pre-contractual duty based on the principle of good faith. There are duties to disclose, inform, keep confidentiality and protect the rights and interests of the other party in negotiation, which are brought together under the general

18. KARL LARENZ ET AL., ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS 45 (2012).
19. Jhering, *supra* note 8, at 363.
20. LARENZ ET AL., *supra* note 18, at 44.

principle of good faith, and the violation of those pre-contractual duties would invoke *culpa in contrahendo*. The second erosion is provided by the reform of obligation law. According to § 311(2) of the BGB, there is a general duty of care during the pre-contractual period in accordance with the duty of care in the performance of contract.

The interaction between the protection of reliance and good faith is complex and controversial, rising to the level of legal philosophy.[21] However, from a practical perspective the consequence of the shift from protection of reliance to good faith is evident. The former purpose of *culpa in contrahendo* was not to punish an act in violation of good faith; it aimed to provide remedies for the party suffering losses without an existing umbrella of contract. The justification of this remedy is through the assurance of the suffering party that there is or will be an effective contract and it is the other party that has invalidated the existing or future contract. The reliance deserves protection only when it is legitimate in the public view. This means an ordinary person who is in the position of the suffering party would produce the same reliance. Even before the 2002 reform, with the special provisions in the BGB when the reliance is legitimate, there was no need to take account of the negligence or intention of the infringing party, including § 122 (Reliance on void or avoided declaration of intent), § 179 (Reliance on the authorized agency). The erosion of good faith means that the emphasis has been put on the subjectivity of the infringing party. The legitimate reliance as a control mechanism in *culpa in contrahendo* has been kept by German Federal Court of Justice (BGH) to limit the protective duty in a more objective approach.

From the EU perspective, besides the Article 2: 301 of the PECL,[22] recent researches on the possible harmonization- the Principles of the Existing EC Contract Law (ACQP) and Draft Common Frame of Reference (DCFR) also reveal the reinforcement of social ethics in the pre-contractual phase. The ACQP begins with a general duty.[23] The DCFR stipulated a

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21. For the function of "good faith" in German civil law, *see* GOOD FAITH AND FAULT IN CONTRACT LAW 171-90 (Jack Beatson & Daniel Friedmann eds., 1997); BASIL S. MARKESINIS ET AL., THE GERMAN LAW OF CONTRACT: A COMPARATIVE TREATISE 119 (2006). For the German explosion of good faith, *see* Marietta Auer, *Good Faith: A Semiotic Approach*, 10 EUR. REV. PRIV. L. 279, 279-301 (2002).

22. Principles of European Contract Law § 2:301 (ex art. 5.301) Negotiations Contrary to Good Faith:

"(1) A party is free to negotiate and is not liable for failure to reach an agreement.

(2) However, a party who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party.

(3) It is contrary to good faith and fair dealing, in particular, for a party to enter into or continue negotiations with no real intention of reaching an agreement with the other party."

23. Principles of the Existing EC Contract Law § 2:101 Good faith: "In pre-contractual dealings, parties must act in accordance with good faith."

§ 2:103 Negotiations contrary to good faith:

similar provision of "negotiations contrary to good faith and fair dealing" in II. – 3:301 as:

> II. – 3:301: Negotiations contrary to good faith and fair dealing
> (1) A person is free to negotiate and is not liable for failure to reach an agreement.
> (2) A person who is engaged in negotiations has a duty to negotiate in accordance with good faith and fair dealing and not to break off negotiations contrary to good faith and fair dealing.
> (3) A person who is in breach of the duty is liable for any loss caused to the other party by the breach.
> (4) It is contrary to good faith and fair dealing, in particular, for a person to enter into or continue negotiations with no real intention of reaching an agreement with the other party.[24]

D. *Comparative Conclusion: Business Ethics and Legal Certainty*

In examining how German and English Law view the pre-contractual relationship, the main controversy of two systems should fall within the position of good faith. As Professor Cartwright said,

> [T]he civil law systems are by no means identical in the detail of their approach, but they have in common a general acceptance of duties in negotiation and performance which are based on, or articulated through the language of, good faith. English Law, however has rejected any general duty of good faith in either formation or performance of the contract.[25]

Though in English Law, the test of reasonable reliance plays a vital role in determining whether to impose a duty of care, or grant a reimbursement in favor of one party against the other in unjust enrichment, which sometimes

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"(1) A party is free to negotiate and is not liable for failing to reach an agreement.
(2) However, a party who has conducted or discontinued negotiations contrary to good faith is liable for loss caused to the other party.
(3) In particular, a party acts contrary to good faith if it enters into or continues negotiations with no real intention of reaching an agreement."

24. STUDY GRP. ON A EUROPEAN CIVIL CODE & RESEARCH GRP. ON EC PRIVATE LAW, PRINCIPLES, DEFINITIONS AND MODEL RULES OF EUROPEAN PRIVATE LAW: DRAFT COMMON FRAME OF REFERENCE (DCFR) 246 (Christian von Bar et al. eds., 2009). For the development of good faith in a worldwide range, *see* Edward Allan Farnsworth, *Duties of Good Faith and Fair Dealing Under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, 3 TUL. J. INT'L & COMP. L. 47, 47 (1995).

25. John Cartwright, *Interpretation of English Law in Light of the Common Frame of Reference*, *in* CONTENT AND MEANING OF NATIONAL LAW IN THE CONTEXT OF TRANSNATIONAL LAW 197, 201 (Henk Snijders & Stefan Vogenauer eds., 2009).

makes its function similar to good faith, it is totally irrespective of social ethics, similar to the early stage of *culpa in contrahendo*. What English Law aims at is not to make negotiation trustworthy since a businessman should have his own judgment rather than being controlled by someone else. Even where the counterparty makes a misrepresentation which convinces him, there is not necessarily a liability.

Besides this, a point to which more attention must be paid is that of legal certainty. The logic underlying English Law is that if a duty is designed to be enforceable or to have binding force, it must be certain enough to give explicit guidelines to the person owed it and to make clear to him the consequences of non-compliance. It should also give judges an explicit policy to examine compliance with the duty. In the pre-contractual context, it is difficult to define the duty to negotiate in good faith in specific cases and Lord Ackner regard it "[u]nworkable in practice",[26] as it is a subjective concept without a clear range and standard.

In considering the certainty, English Law even declines the duty to negotiate as Lord Denning MR pointed "[N]o court could estimate the damages because no one can tell whether the negotiations would be successful or would fall through: or if successful, what the result would be" and "[I]t is too uncertain to have any binding force".[27] English Law prefers the objective criterion such as reasonable endeavors or reasonable reliance than the subjective standard of good faith.[28] What remarkable is that reasonable reliance serves as the premise to grant any remedy in tort, which will be explained in next chapter.

IV. THE ROLE OF TORT IN THE PRE-CONTRACTUAL PHASE

A. *Introduction*

The above discussion highlighted the different positions taken by German and English Law on how to view the pre-contractual phase, underlying different values and policies as mentioned before. This chapter will shift to the role that the law of tort can play to support those underlying policies in the pre-contractual phase.

At first glance, there is a great contrast between German and English Law: German Law inclines towards imposing pre-contractual liability independently in *culpa in contrahendo* rather than tort, whereas in England, tort, though somehow restrictive, is the main regime which can open-up

26. *Miles*, 2 AC (HL) at 138.

27. Courtney & Fairbairn Ltd. v. Tolaini Brothers (Hotels) Ltd. [1975] 1 WLR 297, 301.

28. JOHN CARTWRIGHT, FORMATION AND VARIATION OF CONTRACTS: THE AGREEMENT, FORMALITIES, CONSIDERATION AND PROMISSORY ESTOPPEL 12 (2014).

pre-contractual liability when there is not an enforceable pre-contract. The question here is why they are so different. This chapter will answer this issue by examining two closely-related issues.

In both systems, negotiating parties could assume responsibility towards each other in the pre-contractual phase, under the protective duty in German Law and the duty of care in English Law. The differences lie in the following aspects: the condition on which the duty is imposed; the point at which the duty begins and the content of duty, merely relating to providing information, or more radically to protecting the other party from suffering losses in pre-contractual negotiations.

Furthermore, there are competing policies at play in the pre-contractual phase: the protection of reliance, the freedom of contract and the security of transaction-especially legal certainty. There is a need for a control mechanism, which serves to strike a balance of protection to be afforded to negotiating parties, as well keeping a tight control on pre-contractual liability to prevent it going too far, especially where the liable party has no knowledge about his breach of the pre-contractual duty. What are the differences between German and English Law in fitting their respective control mechanisms? Do those differences relate to the duty in the pre-contractual phase? The comparison in this chapter will cast light on the answers to those questions.

B. *German Law: Preference for Culpa in Contrahendo Rather than Tortious Liability*

Though there is a theoretical possibility to impose tortious liability in the pre-contractual negotiations, German Law prefers to apply *culpa in contrahendo*, making it independent from the tortious regime. What role does the duty of care play in the preference for *culpa in contrahendo*? Is there any deep-rooted objection to the application of the law of tort in pre-contractual phase? Those questions will be clarified here.

1. *Prima Facie Duty of Care in the Pre-Contractual Phase*

The starting point is that there is not a distinction between acts and words in German Law. Misrepresentation as a category is also regarded as acts rather than words. When it comes to the tortious act, it is natural to distinguish between intention and negligence. Though it is still the basis of the German tortious regime, this division is of no account in *culpa in contrahendo* owing to the *prima facie* and general duty of care in the pre-contractual phase.

The culpability of the intention lies in the foreknowledge of the fault

and the damage resulting along with the desire to inflict such damage. Conversely, as for negligence, there is no foreknowledge required at all. The reason why a negligent person is held liable cannot be anything else but the existence of the duty of care. The duty of care actually works as the gatekeeper or control mechanism to prevent imposing liability on innocent people. However, in German Law, the duty of care is automatically, naturally and generally imposed on negotiating parties. It is because of the general duty of care in the pre-contractual phase that the significance of the duty of care in limiting the tortious regime has diminished.

Before the 2002 reform, the pre-contractual duty of care was based on the theory of a group of duties. According to this theory, the group of duties is implied in the nature of the obligation as an interactive relationship.

It is the nature of obligation to shape the form of duties between interactive parties. If the relationships were adversarial, it would be too demanding to obligate a counterparty to act as a protector or administrator to the interests of the other party at the level of contracts. Owing to this factor, the relationship German jurists would like to build is one of "the Good Samaritan" through setting up a group of duties within obligation law and thus including the general duty of care. This is why the theory of a group of duties is believed to be based on the principle of good faith.[29]

In the elaborated group of duties, there is a basic division between the duty of performance and duty of care, as indicated in § 241, BGB. The duty of performance, as the core and basis of obligation, includes primary performance and secondary performance. Primary performance is the essential and main purpose of obligations such as the delivery of goods in the sale contract, whereas secondary performance, such as the delivery of a certificate or an amendment of register, is the duty which ensures and consolidates the effects of primary performance.[30] The duty of care can also be called protective or auxiliary duty. A protective duty means one party takes care of the rights and interests of the other party.[31] Auxiliary duty has a wider scope however, and not only includes the protective duty but also covers auxiliary acts, for example informing, disclosure, assistance and keeping confidentiality in order to help realize the purpose of contracts.[32] If the obligor fails to perform either the duty of performance or the duty of care, the original duty will transfer to the derived duty of performance *i.e.* damages.[33]

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29. KARL LARENZ, LEHRBUCH DES SCHULDRECHTS, BAND I, ALLGEMEINER TEIL 29 (1987).

30. WANG, *supra* note 5, at 36-37.

31. MEDICUS, *supra* note 7, at 3 ¶ Protective duty (Schutzpflichten); MARKESINIS ET AL., *supra* note 21, at 126.

32. LARENZ, *supra* note 29, at 31-33 ¶ Auxiliary duty (Verhaltenspflichten).

33. *Id*. at 38.

Legal duties do not merely affect the contractual period, duties also occur during pre- and post- contractual periods. Pre-contractual duties and post-contractual duties are all protective or auxiliary duties in nature. However, before the reform in 2002, The Federal Court of Justice of Germany (BGH) did not admit the general duty of care in pre-contractual phase without explicit arrangements between negotiating parties but rather it imposed specific duties on the ground of the good faith principle on a case by case basis. For example, the BGH held that German companies had duties to inform foreign companies of the mandatory rules regarding approval of foreign exchange.[34] The BGH in another case decided that in the negotiation for a guarantee contract, the creditor did not have the duty to inform the guarantor of the risk.[35] In the negotiation for a sale of land, the seller did not have the duty to reminder the buyer about the statutory requirement of formality.[36]

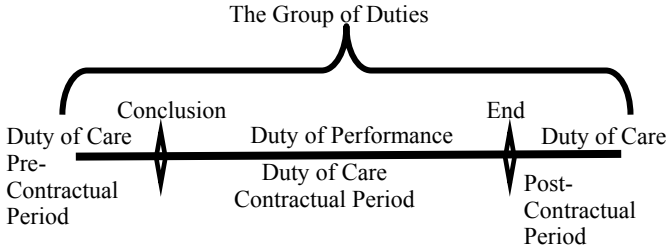

Figure: The Group of Duties

Source: Author

Legislators went further in 2002 reform by enforcing the duty of care in the contractual period in advance in § 311(2), BGB. Since then, the pre-contractual duty of care is no longer a duty implied in the obligation but is rather a statutory duty. In this sense, nearly all careless acts in negotiation causing losses to the other party would invoke *culpa in contrahendo*.

As Professor Medicus said, the obligation here is a complex frame, with organisms or processes comprising of various specific duties. The use of *organism* or *process* in legal terminology reveals another characteristic of that group of duties: it is dynamic and continuously developing over time as opposed to a rigid and static entity.[37] However, precisely owing to this, when duties are placed in a business context, this group of duties can

34. Bundesgerichtshof [BGH] [Federal Court of Justice] Oct. 13, 1955, ENTSCHEIDUNGEN DES BUNDEGERICHTSHOFES IN ZIVILSACHEN [BGHZ] 18, 248 (Ger.).

35. Bundesgerichtshof [BGH] [Federal Court of Justice] Mar. 16, 1983, NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1983, 1850 (Ger).

36. MEDICUS, *supra* note 7, at 66.

37. *Id*. at 5.

produce uncertainty and increase the cost in all processes of contract, causing potential problems for interested parties.

2. *Theoretical Possibility to Open-up the Pre-Contractual Liability in Tort*

There are several possible explanations for the German preference of the *culpa in contrahendo* rather than tort law. The first step here is to sketch out the structure of the tort law in Germany as the basis for further discussions.

In the BGB Book 2 (the law of obligations), Title 27 (Torts), there are three general rules that demonstrate the characteristics of the German approach to torts which currently lies between the French system of general rules and the English system of specific rules. These three rules can be found in § 823(1): infringement of rights, § 823(2): the violation of a statutory rule and § 826: intentional infliction of damage *contra bonos mores*.[38] The basic logic of this design is that there should be differential treatment between rights and interests.[39] In principle, only rights can be protected by torts whereas interests can only be protected exceptionally.

Though § 823(1), § 823(2) and § 826 use some open expressions, such as "another right", "a breach of a statute" or "public policy" to overcome the strictness of torts and make room for the discretion of judges in the intermediate zone, German jurists have elaborated various theories to precisely define and limit discretionary space, causing the tortious regime to become very strict. The theories and resulting expressions are discussed below.

(a) Intentional or Negligent Infringement of Rights in § 823(1)

§ 823(1) states that "[A] person who, intentionally or negligently, unlawfully injures the life, body, health, freedom, property or another right of another person is liable to make compensation to the other party for the damage arising from this". This statement, by its expression of "another right" (*Sonstiges Recht*) provides possible access for "contractual rights" or "pre-contractual rights" to torts, which means the law of tort can play a part

38. CEES VAN DAM, EUROPEAN TORT LAW 78 (2013).

39. MARKESINIS ET AL., *supra* note 21, at 208. Chinese literature, *see* Chen Chung-Wu (陳忠五), *Lun Qiyue Zeren Yu Qinquan Zeren De Baohu Keti: "Quanli" Yu "Liyi" Qubie Zhengdangxing De Zaifansheng* (*論契約責任與侵權責任的保護客體：「權利」與「利益」區別正當性的再反省*) [*Essay on the Protected Objects of Contractual Liability and Delictual Liability: Rethinking the Legitimacy on the Distinction between Rights and Interests*], TAIDA FAXUE LUNCONG (臺大法學論叢) [NAT'L TAIWAN U. L.J.] 51 (2008); Yu Fei (于飛), *Qinquanfa Zhong Quanli Yu Liyi De Qufen Fangfa* (*侵權法中權利與利益的區分方法*) [*The Division between Rights and Interests in Tort Law*], 4 FAXUE YANJIU (法學研究) [CHINESE J.L.] 104, 104-19 (2011).

in enforcing the underlying policies of the contract. Despite this, most jurists believe obligation is naturally excluded from the range of rights in torts because the privity of obligation.[40]

Larenz and Canaris raised the argument "another right" in § 823(1) should be understood as similar to ownership in nature, fulfilling three requirements: the effect of belonging (*Zuweisungsgehalt*), the effect of eliminating interventions (*Ausschlussfunktion*) and social publicity (*Sozialtypische Offenkundigkeit*). They argue this owing to the fact that the basis of torts is, most relevantly, that of belonging and the elimination of interventions into this right of ownership. When an object belongs to someone and that person has rights to dispose of or eliminate interventions from others based on statutes, an explicit, precise and definite legally protective scope of torts is created to protect the suffering party. Social publicity, revealing respect for the freedom to act, allows potential infringing parties to know what the legal consequences of their actions are and to consider whether to act or not.[41]

Fuchs held the same view in a similar expression that another right should possess the positive *Zuweisungsfunktion* and negative *Ausschlussfunktion* as an absolute *recht*.[42] Another right is also considered to include two rights created by the BGB: the right to business (*Recht am Gewerbebetrieb*) and the general personality right (*das allgemeine Persönlichkeitsrecht*), but these are still hard to cover *culpa in contrahendo* as their specific function in law is hard to define.[43]

(b) Intentionally Contradicting Public Policy in § 826

§ 826 states that, "[A] person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable to the other person to make compensation". Public policy can be interpreted in different ways and the most accepted view regards it as the doctrine of "*contra bonos mores*", which means acting contrary to recognized good custom and moral norms of a society.[44] However, the increasing divergence of moral convictions in society has cast doubt on the value of *contra bonos mores* and

40. Hein Kötz, *Doctrine of Privity of Contract in the Context of Contracts Protecting the Interests of Third Parties*, 10 TEL. AVIV. U. STUD. L. 195, 195-212 (1990).

41. KARL LARENZ & CLAUS-WILHELM CANARIS, LEHRBUCH DES SCHULDRECHTS, BAND II, BESONDERER TEIL 375 (13th ed. 1994).

42 MAXIMILIAN FUCHS, DELIKTSRECHT: EINE NACH ANSPRUCHSGRUNDLAGEN GEORDNETE DARSTELLUNG DES RECHTS DER UNERLAUBTEN HANDLUNGEN UND DER GEFÄHRDUNGSHAFTUNG 210 (2010).

43. VAN DAM, *supra* note 38, at 88.

44. This principle is very neatly expressed in the BGB: "Any act done willfully by means of which damage is done to another in a manner *contra bonos mores* is an unlawful act." In James Barr Ames, *Law and Morals*, 22 HARV. L. REV. 97, 111 (1908).

the application of § 826 should be limited to the act contrary to the existing economic or legal order such as abuse of rights or unfair competition.[45] Though it is possible to claim *culpa in contrahendo* on the basis of § 826, the high threshold and especially the responsibility of proving intention makes it difficult.[46]

(c) Breach of a Protective Statute in § 823(2)

§ 823(2) sets out that the duty to compensate damages is also held by "a person who commits a breach of a statute that is intended to protect another person." The practical significance of § 823(2) lies particularly in the area of liability for pure economic loss, since § 823(1) does not protect against this type of loss and § 826 requires the intentional behavior of the tortfeasor.[47] Though the scope of statute is wide, to the extent of even including administrative measures or provisions, judge-made pre-contractual duty in case law (*Richterrecht or Rechtsfortbildung*) is not within the scope of statute therefore *culpa in contrahendo* is a difficult concept to include when dealing with this issue.[48]

3. *Why Not Tortious Liability in the Pre-Contractual Phase?*

There are several explanations as to why the law of tort cannot be used to open-up pre-contractual liability in Germany.

The first explanation is that the law of tort cannot cover the losses in the pre-contractual phase. The German tortious regime is too strict and, in principle, only rights can be protected by torts whereas interests can only be protected exceptionally. The reason why the gap caused by this division is critical lies in the fact that which a party suffers in the pre-contractual period is mostly financial or monetary loss; these are not the consequences of the infringement of personal or property rights, meaning that it is hard to claim *culpa in contrahendo* within the German frame of torts.

The second explanation is that there is a long-standing notion that the hard division between contracts and torts should be maintained and torts should not deal with issues related to contracts.[49] The reason why

45. VAN DAM, *supra* note 38, at 83.

46. For Chinese literature about contra bonos mores in tort, *see* Yu Fei (于飛), *Weibei Shanliang Fengsu Guyi Zhiren Sunhai Yu Chuncui Jingji Sunshi Baohu* (*違背善良風俗故意致人損害與純粹經濟損失保護*) [*Contra Bonos Mores and the Protection of Pure Economic Loss*], 4 FAXUE YANJIU (法學研究) [CHINESE J.L.] 43, 43-60 (2012).

47. VAN DAM, *supra* note 38, at 285.

48. MEDICUS, *supra* note 7, at 70.

49. For the theoretical division between contracts and torts, *see* Wang Li-Ming (王利明), *Qinquan Zerenfa Yu Hetongfa De Jiefen: Yi Qinquan Zerenfa De Kuozhang Wei Shiye* (*侵權責任法與*

pre-contractual damages are difficult to claim in terms of torts is not simply due to a gap in torts or the strictness of torts; there are other significant factors in play. The rooted notion is that there should be a clear line between contracts and torts in German Law, which not only serves as the reason for the gap in torts but also makes judges hesitate to deal with issues relating to contracts using the law of tort even where there is no effective contract. So, the declining of pre-contractual liability in torts is not a problem of objective "possibility" or "ability", but a problem of subjective "unwillingness". The clear division between contracts and torts serves as an excuse to limit the scope of torts, but this was due to considerations of custom or emotion more than substantial need. In fact in German Law contracts have been expanding and eroding the territory of torts, which can also be shown by the substitution of protective duties in contracts for duty of care in torts (§ 241(2)), the contract with protective effect for third parties (*Vertrag mit Schutzwirkung für Dritte*, judge-made law) and the positive infringement of obligation (*Positive Forderungsverletzung*, judge-made law).

The third explanation is the admiration for the theory of juridical act (Rechtsgeschäft) in German Law, which is recognized as the theoretical basis of the BGB.[50] The reason why the juridical act has been placed in such a high position within the German civil law system is that it is regarded as the tool of party autonomy, owing to the fact that the juridical act is the bridge between people's free will and the legal effect they wish to come about.[51] If a juridical act can directly give rise to a legal effect granted by law, it must imply the requirement of lawfulness meaning all juridical acts are lawful acts. Parallel with lawful acts, there is a category of unlawful acts, the ordinary type of which is delict (torts). So, in an ideal world, as a main type of juridical act, a contract is a tool of party autonomy but a tort is not. It is this underlying theoretical basis which accounts for the tendency in German law to expand the effect of contracts rather than adopt a powerful

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合同法的界分：以侵權責任法的擴張爲視野) [*The Division between Tort and Contract Law: In the Perspective of the Expansion of Tort*], 3 ZHONGGUO FAXUE (中國法學) [CHINESE LEGAL SCI.] 107, 112 (2011).

50. The juridical act, also called legal transaction in § 311, is a very abstract concept created by Pandekten meaning everyone can freely form social relations according to his/her own will, social relations such as the conclusion of a contract. Similar to the concept of obligation stated throughout the system of the law of obligations (Book 2, BGB), the juridical act, as the principal line runs through the general part (Book 1, BGB). The theory of the juridical act is hailed as the absolute theme of the 19th German legal research winning an impressive worldwide reputation. *See* WERNER FLUME, ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS: ZWEITER BAND, DAS RECHTSGESCHÄFT 31 (2012); Chinese literature, *see* ZHU QINGYU (朱慶育), MINFA ZHONGLUN (民法總論) [THE PANDECT OF CIVIL LAW] 73-84 (2013).

51. Yi Jun (易軍), *Falu Xingwei Zhidu De Lunli Jichu* (*法律行爲制度的倫理基礎*) [*The Ethical Basis of the Juridical Act*], 6 ZHONGGUO SHEHUI KEXUE (中國社會科學) [SOC. SCI. CHINA] 117, 117-29 (2004).

tort approach.

The fourth explanation, also the most presentable and reasonable one, is that the law of tort cannot be applied in the pre-existing relationship. The natural distrust of torts initially arose from the protection of freedom to act. As an imposed burden torts is apt to be abused to restrict the freedom of the public therefore, the scope of torts should be narrowed to prevent frequent blame-giving.[52] The duty of care in the pre-existing relationship such as negotiation is much higher than the duty owed to a stranger. If there is not a tight control, the negotiating parties would very easily invoke tortious liability in pre-contractual phase.[53]

In searching for the reason why *culpa in contrahendo* cannot be embraced by the law of tort when imposing liability on the pre-contractual misconduct in German Law, the significance of the control mechanism in protecting the negotiating parties from too strict liabilities has become prominent. The answer given by the German Law is to apply the independent *culpa in contrahendo* with the test of legitimate reliance as the control mechanism. In contrast, English Law still adheres to the tortious approach, hence the question is what is the control mechanism adopted by English Law in applying the law of tort in pre-contractual phase? The next chapter will elaborate on this issue.

C. *English Law: Placing the Liability within the Nominate Torts*

"English Law knows no such thing as a general liability for damages for wrongs, but must fit the claim within one of the nominate torts"[54] There are two possible bases for opening-up pre-contractual liability in tort: the tort of deceit and the tort of negligence. The main difference between the tort of deceit and the tort of negligence is whether the duty of care is a condition for imposing the liability.

Placing the negligent breach of pre-contractual duty in the tort of negligence is the main focus of this chapter since in contrast with

52. Claus-Wilhelm Canaris, *Schutzgesetze, Verkehrspflichten, Schutzpflichten*, *in* FESTSCHRIFT FÜR KARL LARENZ ZUM 80. GEBURTSTAG 27, 45 (Claus-Wilhelm Canaris & Uwe Diederichsen eds., 1983).

53. Putting torts in the law of obligations indicates the associated relation arising with damages occurring. In other words, the obligation, including duty of performance and duty of care, does not come into existence before occurrence of damage. It is natural to think that for strangers, the degree of care should be low and limited without special legal provisions or intentional maliciousness. It should not infringe absolute rights of others, namely the general duty of care. In contracts, by virtue of an effective obligation, the degree of care should be much higher and the party bearing duty of care should consider all rights and interests related to the contracts in the context of a specific contract, namely specific duty of care. For the general duty of care in German law, *see* Kwame Opoku, *Delictual Liability in German Law*, 21 INT'L & COMP. L.Q. 230, 244 (1972).

54. John Cartwright, *Liability in Tort for Pre-Contractual Non-Disclosure, in* CONTRACT FORMATION AND PARTIES 137, 156 (Andrew Burrows & Edwin Peel eds., 2010).

prima facie pre-contractual duty, English Law is unique in defining the scope of the pre-contractual duty and the conditions of imposing such a duty, which is helpful for further discussion.

1. *Duty of Care in the Tort of Negligence*

The duty of care is a common legal concept in nearly all jurisdictions, which often leads us to ignore the extraordinary differences behind the similar expression. In English Law, the existence of a duty of care is the premise for establishing liability in the tort of negligence. There are several characteristics distinguishing the duty of care in English law from the similar expressions in German Law.

(a) Imposed Exceptionally Rather than Generally

In German Law, the duty of care would arise automatically in the obligation on the basis of good faith and fair dealing. Duty of care is generally implied in the obligation. When an obligation is formed, there is a duty to take reasonable care of the other party. The duty of care can be a source of several specific duties such as disclosure, assistance, protection and confidentiality. However, in English Law, the duty of care is imposed by judges exceptionally on a case-by-case basis, though sometimes a category could be inducted such as "assumption of responsibility". The duty of care only works as a high threshold of the tort of negligence but not a category of numerous specific liabilities.

(b) Triggered by Antecedent Act

In English Law, the duty of care does not arise automatically but is invoked exceptionally by negligent actions and words. It only indicates that whether one person negligently says or does something wrong to another person in a legally protected relationship. In this case, there is a responsibility on the negligent person to protect the other person from potential losses incurred by that negligent conduct or representation. The tort of negligence would be committed in the circumstances that the other person reasonably relies on the misrepresentation. Without fulfilling the assumption of responsibility, even negligent misrepresentation in negotiation cannot invoke the duty of care. As Lord Reid stated:

> [S]o it seems to me that there is good sense behind our present law that in general an innocent but negligent misrepresentation gives no cause of action. There must be something more than the mere

> misstatement . . . The most natural requirement would be that expressly or by implication from the circumstances the speaker or writer has undertaken some responsibility, and that appears to me not to conflict with any authority which is binding on this House.[55]

(c) Precise Scope of the Duty of Care

In German Law, the existence of the duty of care means you should consider all interests of the person to whom you owe the duty in his position. In English Law, even though in negotiation a party owes a duty of care to the other, you only have the duty to take reasonable care to prevent him from suffering losses from your negligent misrepresentation. In negotiation, there is no imposed duty of care to avoid negligent misrepresentation, or duty to disclose information unrelated to the misrepresentation.[56] There is only the duty to avoid losses incurred by misrepresentation when the duty of care has been imposed. The most striking divergence with Civil Law is that, in English Law, the duty of care does not contain the general duty of disclosure unless it is related to misrepresentation or there is a statutory requirement of disclosure.

(d) Towards the General Approach?

It seems that the "neighbor principle" made by Lord Atkin in *Donoghue v. Stevenson*[57] and the three-stage test in *Caparo Industries plc v. Dickman*[58] push the duty of care in English Law towards a general approach.

The attempts are not to impose a general duty of care but to create a general test of formulating the duty of care. The general approach is far from saying the duty of care would generally exist in proximity. Conversely, it still insists on the high threshold of formulating the duty of care based on the specific circumstances of each case. The only difference lies in the judges' analogy or deductions. This means that in general approach it is not necessary for judges to bring the facts of the pending case within those of previous situations in which a duty of care has been held to exist whereas putting the facts into the generalized test is enough. This deduction implies two promises: it is possible to abstract a general test which would be applicable to all circumstances and the specific test works as the

55. Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. [1964] AC 465, 483.

56. CARTWRIGHT, *supra* note 28, at 17-18.

57. Donoghue v. Stevenson [1932] AC 562, 580; *see also* VAN DAM, *supra* note 38, at 102-04.

58. The three-stage test: (1) foreseeability (2) proximity (3) fair, just and reasonable. *See* Caparo Industries plc v. Dickman [1990] 2 AC 605, 609, 618.

specification of a general test. The second is that the duty of care is an open concept and whenever there is no specific test, the general test can fill the gap.

2. *Liability in Tort for Pre-Contractual Misrepresentation: Assumption of Responsibility*

Misrepresentation means that, from an objective point of view, one person communicates false information through either words or conduct. In the pre-contractual phase, misrepresentation is the main cause of tortious liabilities due to the broader coverage of misrepresentation in English Law.

Fraudulent misrepresentation and negligent misrepresentation are treated differently. In English Law, there is no tolerance for fraudulent statements and intentional misleading acts in the pre-contractual negotiations. Damage induced by fraudulent misrepresentation can definitely be redressed under the tort of deceit, as long as the fraud of the defendant can be proven by claimants according to the test of fraud provided by *Derry v. Peek*. [59] Despite this, when the negotiating party makes a misrepresentation negligently, the tort of negligence is somehow restrictive, which will be explained below.

(a) A Special Test for Careless Misrepresentation: Why it is Needed?

The starting point here is to understand why a separate test for careless words (misrepresentation) is needed from that for careless acts, or in other words, why there is a distinction between acts and words within tort of negligence.

The first reason lies in the need to keep a tight control on liability because the potential scope of harm which might be caused by words is so great and unforeseeable: not only as Lord Reid said "quite careful people often express definite opinions on social or informal occasions even when they see that others are likely to be influenced by them; and they often do that without taking that care which they would take if asked for their opinion professionally or in a business connection"[60], but also given the easy and rapid communication of words. It is impossible even for a quite careful person to know the range and outcome of his every word in everyday life. In this sense, the test for words should be stricter than acts. Secondly, there is a greater difficulty in imposing liability for words than acts in practice due to

59. Fraud is established only if there is proof that the false representation was made knowingly, or without belief in its truth, or recklessly, which means there was no honest belief in its truth. *See* Derry v. Peek [1889] LR 14 App. Cas. 337 (HL) 374.

60. *Hedley Byrne*, AC 465 at 482-83.

the lack of the necessary degree of proximity. So, a test taking account of the specificity of the words is needed.

A specific test for the context of a careless misrepresentation made to a person who relies on it and, assumption of responsibility stems from the decision of the House of Lords in case *Hedley Byrne & Co Ltd v. Heller & Partners Ltd.* Whereas, the assumption of responsibility can only be applied exceptionally, not generally as in Lord Aitkin neighborhood principle.

In this case, the plaintiff Hedley Byrne, an advertisement agent, wanted to check the financial position and creditworthiness of a potential transaction counterparty, Easipower Ltd. to make a business decision. By enquiry, they obtained a report from the bank of Easipower, and Heller & Partners Ltd. stating the good financial situation of Easipower. After the conclusion of the contract, Easipower soon went into liquidation and Hedley Byrne lost £17,000. Hedley Byrne then sued the bank for the damages caused by negligent misrepresentation. The decision made by the House of Lords in this case can be summarized by Lord Hodson as:

> [I]n a sphere where a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful enquiry such person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows, or shall know, will place reliance upon it, then a duty of care will arise.[61]

The mechanism of assumption of responsibility operates on the basis of reasonable reliance. In negotiation, if one party, by virtue of his professions, special skills or dominant position invoked the reliance of the other party, unless he explicitly denied taking any responsibility for the accuracy of his representation, he would assume the responsibility of taking reasonable care to avoid negligent misrepresentation.[62]

The granting of damages in the tort of negligence should be considered from two aspects: legitimacy and constraint. The former would deal with why the losses of claimant can be redressed in tort but not ascribed to mere misfortune. The latter, as a control mechanism, works to define the boundary

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61. *Id*. at 503.

62. As Lord Reid stated: [A] reasonable man, knowing that he was being trusted or that his skill and judgment were being relied on, would, I think, have three courses open to him. He could keep silent or decline to give the information or advice sought: or he could give an answer with a clear qualification that he accepted no responsibility for it or that it was given without that reflection or inquiry which a careful answer would require: or he could simply answer without any such qualification. If he chooses to adopt the last course he must, I think, be held to have accepted some responsibility for his answer being given carefully, or to have accepted a relationship with the inquirer which requires him to exercise such care as the circumstances require. *Id*. at 486.

of liability to prevent it from going too far by asking in the specific circumstance why the defendant should take reasonable care towards claimant. If everyone could frequently and easily be liable for the damage of others, even strangers, owing to negligence or ignorance without foreseeability then, as Lord Morris of Borth-Y-Gest said,

> "[T]he ordinary courtesies and exchanges of life would become impossible if it were sought to attach legal obligation to every kindly and friendly act."[63]

In contrast with German Law limiting the scope of tort by dividing rights and interests and expanding the effect of protective duties, English Law, facing the same problem of balancing competing policies, prefers to put the control mechanism within the frame of tort to make it clear and foreseeable. The control mechanism in the English tort of negligence may vary with different tests and in the assumption of responsibility it is an objective test of reasonable reliance and foreseeability.[64]

In the context of the pre-contractual phase, the assumption of responsibility provides dual-barriers for both parties. As for the claimant, only where the reliance is objectively reasonable can the losses incurred correspondingly be redressed under the tort of negligence. For the defendant, only if the losses incurred by his misrepresentation can be objectively foreseen, could the liability be imposed on him. By the control mechanism provided by the assumption of responsibility-reliance and foreseeability, English Law maintains a clever balance.

Compared with other constraints, the assumption of responsibility is more flexible, paying more attention to the facts on a case-by-case basis, revealing more Common Law styles. Without the specific facts, it is impossible to examine whether the reliance is reasonable and the losses are foreseeable. At the same time, the flexible test gives more balance by limiting the protection of reliance to a foreseeable degree, thus avoiding the injustices which may be brought about by the absolute criteria provided by some arbitrary constraints, especially the sweeping approach that economic losses cannot be redressed in the tort of negligence.

No matter whether reliance or foreseeability is determined in the objective test, it gives more certainty to the negotiating parties and uses the

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63. *Id*. at 494.

64. Lord Denning M.R constructed the embryo of assumption of responsibility in misrepresentation in *Candler v. Crane, Christmas & Co*. by asking three questions: "what persons are under such duty?", "To whom do these professional people owe this duty?" and "to what transactions does the duty of care extend?" The first question is about the reasonable reliance and other two are related to the foreseeability, Candler v. Crane, Christmas & Co. [1951] 2 KB 164, 179-82.

objective test to further explain the uncertain concept of "proximity". The spirit of proximity has also implied in the reliance and foreseeability quite well.[65]

(b) Incentives for Applying Special Test

Besides the fact that the assumption of responsibility at present is the only test which can be used to open-up liability within the tort of negligence in the pre-contractual phase, are there any other incentives for applying it in the pre-contractual phase? It is worth examining here what breakthroughs the assumption of responsibility made and what do those breakthroughs mean in the pre-contractual context. In a word, the assumption of responsibility allows a duty of care for misrepresentation, by contrast with acts, causing economic loss, by contrast with damage to persons or property.[66]

The starting point in English Law is that the pre-contractual negotiation itself cannot bring parties into a proximity where the duty of care can arise, that is the immediate cause for the *Caparo* test cannot be applied in the pre-contractual phase. Before *Hedley Byrne* case, the definition of proximity was extremely restrictive owing to the decision made by the House of Lords in *Derry v. Peek.*[67] That decision was widely cited to decline the application of the tort of negligence in careless misrepresentation. [68] The logic behind

65. As Lord Slynn of Hadley said, the test is objective: [I]t is sometimes said that there has to be an assumption of responsibility by the person concerned. That phrase can be misleading in that it can suggest that the professional person must knowingly and deliberately accept responsibility. It is, however, clear that the test is an objective . . . The phrase means simply that the law recognises that there is a duty of care, Phelps v. London Borough of Hillingdon [2001] 2 AC 619, 654.

66. Before *Hedley Byrne* case, in English Law, careless misrepresentation normally would not be held liable partially since careless misrepresentation essentially is not the gun or other dangerous instrument. In *Le Lievre & Dennes v. Gould*, Bowen L.J. held that: [A] man is responsible for what he states in a certificate to any person to whom he may have reason to suppose that the certificate may be shown . . . the law of England does not go to that extent: it does not consider that what a man writes on paper is like a gun or other dangerous instrument, and, unless he intended to deceive, the law does not, in the absence of contract, hold him responsible for drawing his certificate carelessly, Le Lievre & Dennes v. Gould [1893] 1 QB 491, 502. The wandering of courts in admitting careless misrepresentation was vividly described by Lord Denning L.J. as: [Y]ou will find that in each of them the judges were divided in opinion. On the one side there were the timorous souls who were fearful of allowing a new cause of action. On the other side there were the bold spirits who were ready to allow it if justice so required. *Crane, Christmas & Co.*, 2 KB at 178.

In *Hedley* case, Bowen L.J.'s reasoning was expressly overturned by Lord Reid, meaning that in current English Law the degree of dangerousness is irrelevant with whether the tort of negligence can be invoked: [B]owen L.J. was wrong in limiting duty of care to guns or other dangerous instruments, and I think that, for reasons which I have already given, he was also wrong in limiting the duty of care with regard to statements to cases where there is a contract. *Hedley Byrne*, AC 465 at 488-89.

67. Before *Hedley Byrne* case, the House of Lords in *Derry v. Peek* made a decision that there was no duty of care in the context of issuing a prospectus to refrain from making misstatements. Lord Bramwell gave a scope of proximity in imposing duty of care as: "[T]o found an action for damages there must be a contract and breach, or fraud." *Peek*, LR 14 App. Cas. (HL) at 347.

68. An example can be seen in a case *Cann v. Willson*, a valuer employed by the mortgagor negligently made a false valuation of the price of the estate in his report to mortgagee. The mortgagee

those statements is that, if there is no consideration then why should a person hold a duty of care towards the interests of a stranger. That logic was explicitly denied by Lord Reid in *Hedley* case:

> [S]o it must now be taken that *Derry v. Peek* did not establish any universal rule that in the absence of contract an innocent but negligent misrepresentation cannot give rise to an action.[69]

The second incentive is that the assumption of responsibility serves as an exception to the decision made by the House of Lords in *Murphy v. Brentwood District Council* that economic loss could not be redressed in the tort of negligence. It counts for much in the pre-contractual context because almost all losses in that phase are financial. As mentioned before, the basic logic of tort law in Germany is to introduce the concept of pure economic loss or financial loss into the consideration of whether damages can be redressed in tort. If English Law took this approach, it would mean economic loss incurred by fraud could be recovered but negligence could not--a closed construction of the tort of negligence similar to the BGB.

In *Murphy* case, Lord Bridge of Harwich expressed his position that there was not a duty of care towards economic loss.[70] Though it seems to me that the reason why he declined to impose the duty of care to safeguard the plaintiff from economic loss as Lord Denning in a similar case *Dutton v. Bognor*[71] is not because of the nature of economic loss but instead the

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was in reliance on that report and suffered losses owing to the negligence. Chitty, J. held that the valuer should have taken reasonable care when carrying out the valuation. *See* Cann v. Willson [1888] Ch D 39, 42-43. In contrast, in *Le Lievre & Dennes v. Gould*, Lord Esher, M.R., by citing *Derry v. Peek*, held that *Cann v. Willson* was overruled: [C]hitty, J., in deciding that case, acted upon an erroneous proposition of law, which has been since overruled by the House of Lords in *Derry v. Peek* when they restated the old law that, in the absence of contract, an action for negligence cannot be maintained when there is no fraud. *See Gould*, 1 QB at 497. The similar position was expressed by Bowen L.J. in the same case: "[T]hen *Derry v. Peek* decided this further point-viz, that in cases like the present, there is no duty enforceable in law to be careful."

69. *Hedley Byrne*, AC 465 at 484.

70. As Lord Bridge of Harwich stated, "[B]ut it is not recoverable in tort in the absence of a special relationship of proximity imposing on the tortfeasor a duty of care to safeguard the plaintiff from economic loss . . . These economic losses are recoverable if they flow from breach of a relevant contractual duty, but, here again, in the absence of a special relationship of proximity they are not recoverable in tort", Murphy v. Brentwood District Council [1991] 1 AC 398, 475.

71. Lord Denning M.R. in a similar case expressed opposite opinion: "[M]rs. Dutton has suffered a grievous loss. The house fell down without any fault of hers. She is in no position herself to bear the loss. Who ought in justice to bear it? I should think those who were responsible. Who are they? In the first place, the builder was responsible. It was he who laid the foundations so badly that the house fell down. In the second place, the council's inspector was responsible. It was his job to examine the foundations to see if they would take the load of the house. He failed to do it properly. In the third place, the council should answer for his failure. They were entrusted by Parliament with the task of seeing that houses were properly built. They received public funds for the purpose. The very object was to protect purchasers and occupiers of houses. Yet they failed to protect them. Their shoulders are broad enough to bear the loss", Dutton v. Bognor Regis Urban District Council [1972] 1 QB 373,

absence of a special relationship of proximity. It is widely interpreted as a general conclusion that economic loss cannot be redressed.[72] The most powerful objection was expressed by Lord Denning MR in his dissenting judgment in the *Candler* case:

> [I] must say, however, that I cannot accept this as a valid distinction. I can understand that in some cases of financial loss there may not be a sufficiently proximate relationship to give rise to a duty of care; but, if once the duty exists, I cannot think that liability depends on the nature of the damage.[73]

When applying the assumption of responsibility in the pre-contractual phase, there is no need to consider the nature of losses, as Lord Steyn stated:

> [T]he extended Hedley Byrne principle is the rationalization or technique adopted by English Law for the recovery of damages in respect of economic loss caused by the negligent performance of services.[74]

3. *Applying Assumption of Responsibility in the Pre-Contractual Negotiation*

When it comes to the pre-contractual phase, the position of misrepresentation changes since English Law only uses the assumption of responsibility to open-up pre-contractual liability in the tort of negligence. The question here is to what degree the assumption of responsibility can be applied in the pre-contractual phase at present, or more radically, whether the distinction between words and acts can be broken down, and correspondingly whether the assumption of responsibility can be applied expansively to establish a category of duty of care in the pre-contractual phase beyond the duty relating to misrepresentation in future.

Esso Petroleum Co Ltd v. Mardon is an example of misrepresentation in negotiation invoking the tort of negligence. The plaintiff, Mr. Mardon, was negotiating with Esso Petroleum Co. Ltd. to buy a petrol station franchised by Esso. In negotiations, Esso's estimated throughput of the petrol station in Eastbank Street was 200,000 gallons a year. However, Esso did not take into

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397-98.

72. PURE ECONOMIC LOSS IN EUROPE 316 (Mauro Bussani & Vernon Valentine Palmer eds., 2003); JOHN MURPHY & CHRISTIAN WITTING, STREET ON TORTS 130 (2012); CHRISTIAN VON BAR & ULRICH DROBNIG, THE INTERACTION OF CONTRACT LAW AND TORT AND PROPERTY LAW IN EUROPE: A COMPARATIVE STUDY 581 (2004).

73. *Crane, Christmas & Co.*, 2 KB at 180-84.

74. Williams v. Natural Life Health Foods Ltd. [1998] 2 All ER 577, 581.

consideration that the local council had made a decision regarding planning permission, causing no direct access to Eastbank Street. Mr Mardon bought the petrol station and business was unsuccessful. Esso then brought an action for possession against Mr Mardon, who counterclaimed for damages of Esso's breach of warranty in contract or duty of care in the tort of negligence.

According to Lord Denning MR's reasoning, during negotiations, Esso was in a much better informed position than Mr Mardon. Esso made the forecast intending that the other should act upon it but they themselves did not. Here is both breach of the contractual warranty and breach of the duty of care to make a sound and reliable representation. The damages are the same regardless of whether they are sued in contract or in tort.[75]

As mentioned before, since *Esso Petroleum Co Ltd v. Mardon*, it has been established in English Law that the assumption of responsibility is capable of applying to pre-contractual misrepresentations.[76] As Lord Denning said, "[T]here is no logical reason why the *Hedley Byrne* principle should not apply to a negligent forecast. A duty of care can arise in pre-contractual situations".[77] Another point in this case is that Lord Denning made clear who would assume responsibility in the pre-contractual context. The special knowledge or skill of a party would be enough to render him responsible, and he does not have to be a professional like auditor, accountant, lawyer or banker as in the *Hedley* case. The practical significance lies in the fact that, negotiation essentially is a process of communicating information and inevitably the party under whose control the subject matter (asset or right) of negotiation is, like the petrol station in the *Esso* case, would have special knowledge than the other, i.e. in the negotiation for purchasing a house, the seller, also the owner, definitely has special knowledge about that house, which means he has to assume the

75. Lord Denning M.R. stated: [I]f a man, who has or professes to have special knowledge or skill, makes a representation by virtue thereof to another . . . with the intention of inducing him to enter into a contract with him, he is under a duty to use reasonable care to see that the representation is correct, and that the advice, information or opinion is reliable. Esso did profess special knowledge and had it. Their negligent misstatement was a fatal error . . . A professional man may give advice under a contract for reward; or without a contract, in pursuance of a voluntary assumption of responsibility, gratuitously without reward, Esso Petroleum Co. Ltd. v. Mardon [1976] QB 801, 820.

76. Before *Esso Petroleum Co. Ltd. v. Mardon*, in English Law pre-contractual relations would not normally come within the "special relationship" duty evolved in the *Hedley Byrne*. "[T]here is no reported case where it has been held that the *Hedley Byrne* duty arose in respect of advice or information relating to a future forecast as opposed to a statement of a present fact or opinion; and, if the majority opinion of the Privy Council in Mutual Life & Citizens' Assurance Co. Ltd. v. Evatt [1971] AC 793, is accepted, that duty only arises where the representor carries oh the business of giving advice, or holds himself out as possessing the necessary skill and competence." *Id*. at 812. Also as Lord Denning stated: "[I]t has been suggested that *Hedley Byrne* cannot be used so as to impose liability for negligent pre-contractual statements: and that, in a pre-contract situation, the remedy (at any rate before the Act of 1967) was only in warranty or nothing", *id*. at 818.

77. *Id*. at 813.

responsibility to ensure the accuracy of his words which are communicated to the potential buyer during negotiations according to the *Esso* case.

The Supreme Court of the UK in its decision in a recent case *Cramaso LLP v. Ogilvie-Grant and Others*, which concerned the use of one party of misleading figures to respond to the enquiries from the other in the pre-contractual negotiations for a lease of a moorland in Scotland, reaffirmed the decision made in the *Esso* case. The Supreme Court in its decision admitted that in pre-contractual negotiations there is a continuing responsibility of the representor for the accuracy of the information. As Lord Reed JSC said,

> [T]he law is thus capable, in appropriate circumstances, of imposing a continuing responsibility on the maker of a pre-contractual representation in situations where there is an interval of time between the making of the representation and the conclusion of a contract in reliance on it, on the basis that, where the representation has a continuing effect, the representor has a continuing responsibility in respect of its accuracy.[78]

Lord Toulson JSC went a step further. He not only admitted the continuity of misrepresentation, but also that the assumption of responsibility is a general principle in the pre-contractual negotiation for the reason that in negotiations generally it would be reasonable for the representee to rely on the misrepresentation made by the other party as:

> [A]s a matter of general principle, a representation made during contractual negotiations for the purpose of inducing a contract will ordinarily be regarded as continuing until the contract is actually concluded because it will generally be reasonable for the representee to continue to rely on it.[79]

It makes sense that the assumption of responsibility has developed into a general principle for misrepresentation in the pre-contractual negotiations. There is not so such concern that the harm caused by words would be great and unforeseeable since negotiation is a formal and serious occasion, in which the party making the representation normally knows the representee and the consequences his words will bring to his counterparty- the other party would reasonably rely on it because the representor has more knowledges on the subject matter than he.

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78. Cramaso LLP v. Ogilvie-Grant [2014] 1 AC 1093, 1104.
79. *Id*. at 1112.

There has also been an attempt to develop the assumption of responsibility beyond the sphere of misrepresentation.[80] In *Henderson v. Merrett Syndicates Ltd*, Lord Goff treated the assumption of responsibility as authority not simply for negligent statements giving rise to economic loss, but also more generally for the negligent acts or omissions in such a way as to cause economic loss, as he said: "[T]hough *Hedley Byrne* was concerned with the provision of information and advice, . . . show that the principle extends beyond the provision of information and advice to include the performance of other services"[81] and "[A]n assumption of responsibility by, for example, a professional man may give rise to liability in respect of negligent omissions as much as negligent acts". [82]

However, the development made in the *Henderson* case dealt with the problem that the economic loss caused by the negligent act or omission in the performance of service cannot be redressed in the tort of negligence since the decision of House of Lords in the *Murphy* case, without reference to pre-contractual negotiations. Until now, the *Henderson* decision has not been extended to apply in the pre-contractual context to impose a category of duty of care, especially the duty to act positively, beyond the sphere of misrepresentation. The distinction between words and acts in the pre-contractual context is still hard to break though, as Lord Reed JSC said in *Cramaso LLP v. Ogilvie-Grant and Others*:

> [T]he law does not impose a general duty of care in the conduct of contractual negotiations, reflecting the fact that each party is entitled, within the limits set by the law, to pursue its own interests . . . Nevertheless, it has long been accepted that the relationship between the parties to contractual negotiations may give rise to such a duty in respect of representations.[83]

Is there a need or possibility for the Supreme Court to change its position to impose a category of duty of care beyond the sphere of misrepresentation? Answer to this question can be found in next chapter.

4. *Assessing Assumption of Responsibility in the Pre-Contractual Context*

Firstly, I would like to compare two currently effective tests of imposing

80. JOHN CARTWRIGHT, MISREPRESENTATION, MISTAKE AND NON-DISCLOSURE 252-53 (3d ed. 2012).
81. Henderson v. Merrett Syndicates Ltd. [1995] 2 AC 145, 180.
82. *Id*. at 181.
83. *Ogilvie-Grant*, 1 AC at 1108-09.

the duty of care provided by the House of Lords and a response to the question as to why in pre-contractual context nearly all damages are granted by assumption of responsibility but not the three-stage test.

There is no doubt that in English Law, negotiation itself is not sufficient to give rise to a proximity in which the duty of care can arise. This means generally there is no duty of care between negotiating parties, otherwise it would work similar to *prima facie* duty in German Law. That is why damages incurred by negligent actions, except for negligent misrepresentation in pre-contractual negotiations, can hardly be recovered in the tort of negligence. The assumption of responsibility provides a means of evading the requirement of proximity, or rather, provides a new category of proximity relating to information.[84] In the assumption of responsibility, proximity does not work directly but is only implied in the requirement of reliance and foreseeability i.e. the more remote the relationship is, the harder it is to recognize the reliance as reasonable and the more possible it is that the negligent person cannot foresee it when he makes representation. In pre-contractual negotiations, when the assumption of responsibility applies, there is no requirement to prove that the negotiation is in proximity, but rather the requirement is to prove that in the negotiations, one party relied on the misrepresentation of the other party by virtue of his skill, special ability or knowledge.

Table 1: Assumption of Duty of Care towards the Economic Loss

Formation of duty of care	Three-stage test (1990)	Assumption of responsibility (1964)
Legitimacy	Fair, just and reasonable	Reliance
Constraint	Foreseeability; Proximity	Foreseeability; Reasonable reliance basis: skill, enquiry, professional

Source: Author

Secondly, considering the special characteristics of negotiation, misrepresentation can indeed contain most forms of misconduct in the pre-contractual phase. Misrepresentation is a wide concept which can be broadly interpreted. "[T]he false statement need not, however, be made through the medium of words, whether written or oral. What is required is that a falsehood be communicated to the claimant; and this can be done by his interpretation of the defendant's actions as well as by his hearing or

84. How the assumption of responsibility fits into the Caparo test, *see Dickman*, 2 AC at 612, 620, 623, 629.

reading the defendant's words."[85] Even true but misleading statements in some circumstances are actionable.[86] The essence of pre-contractual negotiation is the communication of information, both facts and opinions. In negotiation, nearly all false actions would communicate false information and in practice, it is hard to find wrongful conduct other than misrepresentation so long as breaking-off negotiation itself is not regarded as a fault in the law of tort. Following the approach of the assumption of responsibility, the formation of the duty of care is not so restrictive.

We must consider why it is still hard to claim damages in the tort of negligence despite the lenience of the assumption of responsibility for claims in pre-contractual negotiations. I have to say that the reason does not lie in the formation of the duty of care, but rather in the causation between damages and breach of the duty of care. If the assumption of responsibility were fulfilled, this would definitely give rise to a duty of care, but this still requires further steps from the existence of the duty of care to the rise to the tort of negligence. In both *Esso Petroleum Co Ltd v. Mardon* and *Cramaso LLP v. Ogilvie-Grant and Others,* the damages were successfully claimed on the basis that the contract had been concluded and the actual performance Mardon received from Esso was not as profitable as what Esso had forecasted.

This raises another question concerning vitiating factors in the contract but not pre-contractual liabilities. When the negotiation failed rather than succeeded, even though in negotiation the defendant gave misrepresentations, it would be hard to prove what losses the claimant actually suffered. Even though the defendant did not make misrepresentations, the cost of negotiation will also be incurred. Only where the defendant does not intend to conclude a contract at all but rather intends to use negotiation as a sham for other purposes, can the negotiation be said entirely wasted and there is certain causation. When the claimant has already made preliminary preparations for the performance owing to the negligent misrepresentation, those expenditures in English Law are normally recovered by unjust enrichment but not the tort of negligence.

85. CARTWRIGHT, *supra* note 80, at 34.
86. *Id*. at 39, 52.

D. *Comparative Conclusion*

Table 2: The Role of Tort in the Pre-contractual Phase

<table>
<tr><td></td><td colspan="4">Deliberate Tortious Act</td><td colspan="4">Negligent Tortious Act</td></tr>
<tr><td rowspan="3">German Law</td><td colspan="2">Rights</td><td colspan="2">Interests</td><td colspan="2">Rights</td><td colspan="2">Interests</td></tr>
<tr><td>Tort</td><td>? Theoretically possible in § 823(1)</td><td>Tort</td><td>? Theoretically possible in § 823(2) & § 826</td><td>Tort</td><td>? Theoretically possible in § 823(1)</td><td>Tort</td><td>? Theoretically possible in § 823(2)</td></tr>
<tr><td colspan="8">Culpa in contrahendo √
Test: Legitimate reliance</td></tr>
<tr><td rowspan="2">English Law</td><td colspan="4" rowspan="2">Tort of Deceit √</td><td colspan="4">Tort of Negligent</td></tr>
<tr><td colspan="2">Misrepresentation √
Test: assumption of responsibility</td><td colspan="2">Other Omissions ×</td></tr>
<tr><td rowspan="2">Chinese Law</td><td colspan="4">Tort
√ (Only theoretically)</td><td colspan="4">Tort
√ (Only theoretically)</td></tr>
<tr><td colspan="4">Pre-contractual liability in contract law</td><td colspan="4">Pre-contractual liability in contract law</td></tr>
</table>

Source: Author

In summary, several differences can be clearly observed in the approaches taken by Germany and that of England with regards to the duty of care assumed by parties in pre-contractual negotiations: at the moment parties engage in pre-contractual negotiations, the general duty of care towards the other party would arise automatically in German Law; whereas in English Law, the duty of care is imposed exceptionally in line with the principle of the assumption of responsibility, which in the pre-contractual context is limited to careless misrepresentation. In German Law, there is a wide scope of duty: the duty to disclose, the duty to co-operate and the duty to take care of the interests of the other party.

It seems that German Law and English Law have little in common in dealing with misconducts in the pre-contractual phase. However, there are indeed functional similarities underlying those differences.

What is the role of the duty of care in the pre-contractual period in Germany? Someone may theoretically say that the duty of care can positively work as a guideline for the negotiating parties prior to or during negotiations. That may be true but it is not the common practice. The main role of the duty of care is to deal with the dilemmas in imposing liability afterwards- i.e. why an innocent party should be liable for the losses of the other. Some German jurists tend to split the duty of care: on the one hand, the general pre-contractual duty of care is a declaration of the special

protective relationship; on the other hand, when imposing liability, the duty of care is much narrower.[87] Although it is somewhat arbitrary to separate a single concept, that argument at least highlights the need for a control mechanism in German Law: the general duty of care would make the liability easily to arise and hence there should be some limitations to protect freedom in the pre-contractual phase.

In English Law, there are no concerns regarding unlimited liability in the pre-contractual period. On the contrary, the tort of negligence is believed to provide limited access.[88] The reason lies in the fact that English Law established the test of the duty of care as the control mechanism. The duty of care would be imposed only where one party's misrepresentation invokes the objectively reasonable reliance of the other party in the pre-contractual negotiations. The duty of care itself can be the gatekeeper of tortious liability.

The general duty of care makes negligence easily established owing to the fact that the negligence itself is defined as the failure to exercise the duty of care, especially in the pre-contractual context in which each party normally does not intend to tip his hand and let the other party know his intention or real interests until the last minute. As the control mechanism within the concept of negligence has been diminished by the general duty of care, if that duty can still be embraced by the tortious rule that "breach of a statute that is intended to protect another person" in § 823(2), BGB, the threshold would be extremely low and the negotiating parties could easily commit the tort without restrictions. That is the underlying reason why German Law tends to decline to apply the tortious regime especially § 823(2), BGB in the pre-contractual phase. In contrast, in *culpa in contrahendo*, aside from the negligent acts or omissions of the defendant, it is a significant step to examine whether the claimant has legitimately relied on the other party's acts or his compliance with the duty of care. The legitimate reliance in *culpa in contrahendo* functions as a control mechanism.

Therefore, in both German and English Law, the tortious liabilities in the pre-contractual phase, especially the liability for negligent misrepresentation, are all imposed on the basis of the legitimate reliance of the party suffering losses. In English Law, the requirement of objectively reasonable reliance is set in the test of the duty of care; whereas In German Law, the issue of reliance is established as the basis of *culpa in contrahendo*. The reason why the German pre-contractual regime is dependent from the law of tort lies in the existence of the general duty of care. Legitimate

87. MEDICUS, *supra* note 7, at 65-66.

88. PAULA GILIKER, PRE-CONTRACTUAL LIABILITY IN ENGLISH AND FRENCH LAW 105-07 (2002).

reliance, as the essential element of *culpa in contrahendo*, serves as the control mechanism to prevent pre-contractual liability from going too far. In English Law, there is no such necessity for an independent pre-contractual regime.

Although there are some functional similarities between two systems, the core concept "reliance" means different thing-in German Law the reliance is towards the conclusion of contract but in English Law it means the accuracy of information.

V. CONCLUSION

From the above assessment of the CCL and the comparison between the contrasting approaches taken by German and English Law in responding to the questions faced by Chinese legislators in devising the pre-contractual liability, a conclusion can be drawn to answer these questions which can serve as a proposal for the forthcoming Chinese Civil Code.

A. *The Principle of Good Faith Should not Directly Open Up Pre-Contractual Liability*

The draft of the general rules (first part) of the Chinese Civil Code published by Chinese authorities adopts the principle of good faith and security of transaction simultaneously as the overriding principles of Chinese Civil Code, set out in article 6. This is the first time Chinese Law expressly recognized security of transaction as the overriding principle on the same level of significance as the principle good faith, which indicates that the requirement of legal certainty is being emphasized more strongly than before. Unsurprisingly, it will most possibly pass into legislation in the National Congress in March 2017.

In devising the pre-contractual regime, the role of good faith should be giving careful consideration from the outset, especially from the perspective of legal certainty. In the CCL, good faith works as a gap-filling provision, not imposing a general protective duty as does German Law or a general duty to negotiate in good faith as in the PICC, PECL, DCFR and ACQP, which reveals that Chinese legislators aim to strike a balance between the Good Samaritan and the adversarial businessman. This thesis has assessed the actual motion of that gap-filling provision in Chinese legal practice, finding that the outcome is not as ideal as lawmakers had imagined. The experience of the CCL shows that the principle of good faith is inherently uncertain and that when used directly to open-up the pre-contractual liability, this gives rise to a high risk of abuse.

Lord Ackner's statement that the negotiating parties are essentially

adversarial is remarkably shocking for us. In contrast, it is submitted that a less radical expression is preferable-that English Law does not intend to let pre-contractual liability bear the burden of social ethics. This reminds us of an often-ignored issue-that good faith is a concept which must be understood in context. Hence the principle of good faith in the pre-contractual context is completely different to that used in trust, agency and employment.

From the above, we can see that the principle of good faith is an inherently unclear concept. It can be used in the legislative process to help legislators make value judgments but in no event can it directly open up liability, which would be severely detrimental to legal certainty.

B. *A Clear Pre-Contractual Duty in the Chinese Civil Code*

Article 53 of the CCL seems to impose a series of duties in the pre-contractual phase. However, they all boil down to one thing-the duty to prevent fraud, including negotiation as a sham (paragraph 1), intentional misrepresentation or intentional non-disclosure to induce the other party to conclude the contract (Paragraph 2) and the gap-filling provision of good faith implying the duty not to intentionally cause damage to the other party (Paragraph 3).

The open norm of good faith or an expression more close to the original intention in Chinese language honesty leaves room for the further discussions Normally, the principle is strictly interpreted as a gap-filling provision, as mentioned in final section, used to prevent fraud or any other acts carried out with the intention to cause damage to the other party; meanwhile in theory and legal practice the principle could be widely interpreted as the protective duty, as established in German Law. To meet the demands of business for a clear and foreseeable regime of pre-contractual negotiation, the new Chinese Civil Code should make clear from the outset the exact content of pre-contractual duties and the conditions attached to the imposition of duties.

C. *The Scope of the Pre-Contractual Duty: Duty Relating to Information*

The starting point is, as previously established, that the overriding principle of good faith in the Chinese Civil Code does not mean that we must expressly stipulate a general protective duty or duty to negotiate in good faith without choice. We can present it in a more clear and business-friendly way with respect to the pre-contractual context.

There is no definite scope of the protective duty in German Law, which establishes a duty to take account of the rights, legal interests and other interests of the other party. In contrast, the duty of care in English Law is

limited to words-providing information or opinions--and has not developed into an accepted duty for general conduct of the negotiations. The main difference between the two systems in terms of the scope of the protective duty lies in the duty of disclosure during negotiations. In German Law, the protective duty is normally a duty to inform the other party of any risks which may cause losses rather than some other positive acts. In contrast, English Law is largely reluctant to admit the duty of disclosure in an arm's length bargain.

It is somewhat unrealistic for Chinese Law to copy this distinction between words and acts adopted by English Law in applying the assumption of responsibility, since in China representation is viewed as a positive act by declaration rather than the words which are not expressed. That distinction highlights the ultimate nature of negotiation--a process of communicating information. In this sense, the main role of the pre-contractual duty in the Chinese Civil Code is to ensure the negotiating parties are in a well-informed position with accurate and complete information in order to make their decision. Chinese Law can go a step further than English Law with regards to disclosure as a result of the principle of good faith. Besides the duty to ensure accuracy of representation, there can also be a duty not to conceal the truth, to reply to any enquires and to give reminders of any circumstances within his knowledge which would frustrate the purpose of prospective contract. When one party incurs or increases the risk of the other party, they have the duty to promptly inform them of such a risk. In a word, the scope of the pre-contractual duty in the Chinese Civil Code should be limited to the duty of avoiding misrepresentation and the duty of disclosure.

D. *The Assumption of Pre-Contractual Duty--Providing Clear Criteria Rather than a Prima Facie Duty*

When imposing pre-contractual liability on a negotiating party, especially a negligent party who has no knowledge of his duty, in both German or English Law there exists tight controls to limit the extent of this liability, given that pre-contractual liability is not intended to impede negotiations or to force the negotiating parties to engage in overly-cautious negotiating practices. Besides the assumption of liability, there is also a concern that the scope of liability could likely be unlimited since the losses caused in the pre-contractual phase are normally purely economic. Due to the lack of an effective control mechanism and the uncertainty to which good faith may give rise, article 53 of the CCL does not impose pre-contractual liability on a negligent party. If the Chinese Civil Code intends to redress the losses caused by careless misrepresentation and non-disclosure, it should set out clear criteria to do so rather than imposing a general protective duty in

the pre-contractual phase.

In Germany, concerns about pre-contractual liability are further increased due to the approach of German Law in imposing a *prima facie* protective duty. Hence from the moment parties engage in negotiation, each party assumes a general duty to protect the other party from suffering losses. If the breach of such duty can be recovered by German tort, especially § 823(2) concerning breach of a protective statute, pre-contractual liability would become too extensive and negotiating parties could easily be held liable for the losses of their counterparties. The inherent defect of the *prima facie* protective duty explains the significance of *culpa in contrahendo* in the German context--limiting the extent of the pre-contractual duty--and also why the Chinese Civil Code should not adopt a *prima facie* protective duty.

E. *Applying the Law of Tort in the Pre-Contractual Phase*

The law of tort can be applied in the pre-contractual phase for the breach of a pre-contractual duty. There is neither necessity nor practical significance to establish an independent pre-contractual liability such as *culpa in contrahendo* in the Chinese Civil Code.

The futility of German tort law in the pre-contractual phase is due to a great extent in its closed structure, but the root cause is still the *prima facie* protective duty. If breach of the pre-contractual duty fell inside the scope of § 823(2), breach of a protective statute, the liability would be too strict; whereas if it was dealt with in § 823(1), general rule, the protection to be afforded to the negotiating parties would be significantly inadequate. When it comes to China, such problems do not arise. The Chinese Tort Law (CTL) adopts an open framework without distinction between rights and interests. The general rule is stipulated in paragraph 1, article 6: "[T]he one who is at fault for infringement upon a civil right or interest of another person shall be subject to the tort liability." If the scope of the pre-contractual duty and the criteria for imposing such a duty have been clearly defined, as mentioned, there should be no concern about the overexpansion of the pre-contractual liability.

Furthermore, contract law and tort law are not opposites. It would be arbitrary to state that as long as contractual matters are involved, tort law cannot be applied. The underlying logic is that tort law reveals more mandatory characteristics in contrast to party autonomy. From the experience of English Law, that logic is rebuttable. In the pre-contractual phase, damages for misrepresentation can be claimed under tort law. When a materialized contract is voided owing vitiating factors, damages can also be claimed in tort. The peculiarities of the pre-contractual phase have been fully considered in imposing the duty of care. Under a systematical view, the

breach of a non-contractual duty, without absolute necessity, can definitely be recovered in tort.

The conclusive reason to return to tort lies in that tort law provides more certainty than the principle of *culpa in contrahendo*, a difference which can be seen clearly the foregoing comparison. The law of tort does not have the "original sin" of imposing unlimited liability. Via the step-by-step test of the assumption of duty, breach of duty, determination of fault- intention or negligence, and causation makes the process of imposing liability much more certain.

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締約過失責任的法律定位：德國法與英國法的不同路徑

李 瀟 洋

摘 要

中國大陸民法典編纂正在如火如荼地開展。本文旨在從比較法之路徑探討在未來之民法典中如何形塑締約過失責任。於契約前階段的制度設計，中國大陸立法者面臨一個長期爭議的理論問題——締約過失的法律定位，具體而言即契約法中誠實信用原則之違反得否直接導致締約過失責任，以及締約過失責任在性質上是否是一種獨立於侵權責任的特別責任類型。本文將德國法與英國法兩個法域作為比較研究的對象，分析二者於上述問題所採之不同路徑，以供中國大陸立法者參考。本文的比較研究展現了德國法與英國法於締約階段責任制度的顯著不同，並試圖揭示隱含在兩個法域強烈對比中的相似的政策考量及制度安排，並以此為基礎，為中國大陸民法典中締約過失責任的定位提出建議。

關鍵詞：締約過失責任、誠實信用原則、注意義務、控制機制、侵權法之適用