

Precontractual Liability in European Private Law

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3 From the common law to the civil law: the experience of Israel

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The dilemma

Precontractual liability relates to liability from a specific temporal standpoint: the time before a contract has been created. Thus, the very definition of such liability is coupled with a dilemma: if a contract has not been created, why should precontractual liability be imposed? This liability apparently could not be based on contract, since a contract has not been created. On the other hand, if such liability is grounded, for example, either in torts or in restitution it might be incompatible with the contractual principle of no liability. The absence of contractual liability means that the parties are free not to deal. Liability based solely on negotiations might seem to override the negative freedom not to deal. This dilemma is well reflected in the different approaches adopted by the common law, on the one hand, and the civil or continental law, on the other hand.

Israeli law under the common law: no rule of precontractual liability

The common law does not recognise a general principle of good faith which might create a basis for precontractual liability.¹ This derives from a wide application of the principle of the freedom of contract and from what seems to be 'a respect for the contractual rules of the game'. It reflects adherence to the rule of law in the strict sense and to the

¹ S. Whittaker and R. Zimmermann, 'Good Faith in European Contract Law: Surveying the Legal Landscape' in Zimmermann and Whittaker, *Good Faith in European Contract Law*, pp. 39-41 (their discussion relates to the whole concept of good faith).

values of certainty and predictability in law. It gives preference to rules over standards.² It puts emphasis on a clear demarcation line between negotiations and contract. It encourages self-reliance.

Yet certain conduct, even though performed during negotiations, might be improper, and should give rise to liability. The mere fact that this conduct is performed during negotiations does not give immunity from liability. In sum: though the common law does not contain a principle of precontractual liability, it nevertheless employs several devices to monitor conduct during negotiations, in particular through the law of torts, restitution, estoppel and even contract.³

Before the enactment of the Contracts (General Part) Law in 1973,⁴ Israeli contract law was largely dominated by common law rules, a heritage of the British mandate over the country. The cautious approach concerning liability imposed on activities during negotiations also characterised Israeli law. But following English law, and sometimes even preceding it,⁵ Israeli law occasionally employed torts,

² On the much discussed distinction between rules and standards: K. Sullivan, 'The Justices of Rules and Standards' (1992) 106 *Harvard Law Review* 22; L. Kaplow, 'Rules versus Standards: an Economic Analysis' (1992) 42 *Duke Law Journal* 557.

³ For the general qualifications in English law regarding the absence of the duty of good faith: Zimmermann and Whittaker, *Good Faith in European Contract Law*, pp. 41-8. For the use of mechanisms other than a general principle of precontractual liability in English law, see the Conclusions, below, pp. 462-5.

For a general survey of American law: E.A. Farnsworth, 'Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations' (1987) 87 *Columbia Law Review* 217, 233-5. See also G. Shell, 'Opportunism and Trust in the Negotiation of Commercial Contracts: Toward a New Cause of Action' (1991) 44 *Vanderbilt Law Review* 221 (suggesting a new cause of action in American law to guard against opportunism in negotiations). In the same vein: J. Kostritsky, 'Bargaining with Uncertainty, Moral Hazard, and Sunk Costs: a Default Rule for Precontractual Negotiations' (1993) 44 *Hastings Law Journal* 621; A. Schwartz and R.E. Scott, 'Precontractual Liability and Preliminary Agreements' (2007) 120 *Harvard Law Review* 662. For balancing freedom and liability in negotiations: O. Grosskopf and B. Medina, 'Regulating Contract Formation: Precontractual Reliance, Sunk Costs, and Market Structure' (2007) 39 *Connecticut Law Review* 1977.

For a comparative study relating to American and German Law: M. Auer, 'The Structure of Good Faith: a Comparative Study of Good Faith Arguments' (17 November 2006), available at SSRN: <http://ssrn.com/abstract=945594>. On the international level: J. Klein and C. Bachechi, 'Precontractual Liability and the Duty of Good Faith Negotiations in International Transactions' (1994) 17 *Houston Journal of International Law* 1.

⁴ 27 LSI 117 (1973) (Contracts Law).

⁵ Liability for negligent precontractual misrepresentation was first imposed in Israel in CA 76/86 *Amidar v. Aharon*, 32(2) PD 337 (Hebrew), preceding the English case of *Esso Petroleum Co. Ltd v. Mardon* [1976] QB 801.

restitution, estoppel or contract⁶ to impose liability for improper conduct in negotiations.

Section 12 of the Contracts Law

Rule of precontractual liability

The 1973 Contracts Law introduced into Israeli law some novelties, one of which is the duty of good faith which has been applied not only to the stage of performance in section 39,⁷ but also to the stage of the negotiations and the conclusion of the contract.

Section 12 of the Contracts Law, whose title is 'Negotiation in good faith', reads:

- (a) In negotiating a contract, a person shall act in customary manner and in good faith.
- (b) A party who does not act in customary manner and in good faith shall be liable to pay compensation to the other party for the damage caused to him in consequence of the negotiations or the making of the contract, and the provisions of sections 10, 13 and 14 of the Contracts (Remedies for Breach of Contract) Law, 1970 shall apply *mutatis mutandis*.⁸

This section, which embodies the principle of *culpa in contrahendo*, a direct device for imposing a precontractual liability, mirrors the switch to the continental system made by the Israeli legislator. This liability applies either when a contract has not been concluded, or when it has been concluded.

Civil law impact

The concept of *culpa in contrahendo* is continental. It originated in Germany and spread around continental Europe. In the various jurisdictions in which it applies it has different variations, but there is a single idea nurturing it. The contracting parties are not strangers. They rely on each other. They have to be considerate with each other. This is

⁶ N. Cohen, 'Good Faith in Bargaining and Principles of Contract Law' (1990) 9 *Tel-Aviv University Studies in Law* 249, 256-63.

⁷ Which reads: 'An obligation or right arising out of a contract shall be fulfilled or exercised in customary manner and in good faith.'

⁸ Contracts (Remedies for Breach of Contract) Law, 1970 (25 LSI 11), s. 10, provides for the right to compensation; s. 13 grants the court discretion to impose compensation for non-pecuniary loss; and s. 14 provides for reduction of damages in the case where the injured party has not mitigated his loss.

translated into a legal duty imposing an obligation to compensate the party who was injured as a result of the wrongdoing of the other party in the negotiating process.⁹

The principle of good faith derives from a stricter application of the notion of freedom. The idea underlying it is that negotiation is not a liability-free zone. It reflects an emphasis on morality. It indicates a preference for standards and discretion over formal rules.¹⁰ Israeli principle postulates an *a priori* assumption of limitation of freedom of action in the bargaining process, subject to excuses or justifications exempting from liability. It has thus rejected the opposite assumption of English law based on an *a priori* freedom in the bargaining process, subject to special rules imposing liability.

Section 12 and other grounds of precontractual liability

Section 12 serves naturally as the major vehicle for imposing precontractual liability. But section 12 is not exhaustive. The possibility of using tort law, restitution, estoppel and contract still exists, and indeed they are being used.¹¹ Section 12 could be simultaneously employed, provided that there is no double recovery.

Nature of liability under section 12

The Israeli Supreme Court has expressed some doubts as to the nature of liability under section 12 - whether it is grounded in tort or contract - and finally held that it is a liability *ex lege*.¹² It has been argued by

⁹ F. Kessler and E. Fine, "Culpa in Contrahendo", Bargaining in Good Faith, and Freedom of Contract: a Comparative Study' (1964) 77 *Harvard Law Review* 401; G. Kuehne, 'Reliance, Promissory Estoppel and Culpa in Contrahendo: a Comparative Analysis' (1990) 10 *Tel-Aviv University Studies in Law* 279; Hondius, *Precontractual Liability*; A.M. Rabello, 'The Theory concerning Culpa in Contrahendo (Precontractual Liability): from Roman Law to the German Legal System - a Hundred Years after the Death of Jhering' in Rabello, *European Legal Traditions and Israel*, p. 69; D. Snyder, 'Comparative Law in Action: Promissory Estoppel, the Civil Law, and the Mixed Jurisdiction' (1998) 15 *Arizona International and Comparative Law* 695.

¹⁰ For the polar approaches of English and continental systems: H.K. Luecke, 'Good Faith and Contractual Performance' in Finn, *Essays on Contract Law*, pp. 155, 170-1. For a recommendation to include precontractual liability in a future European Code which as an open norm could be differently applied by each system: J. van Erp, 'The Pre-Contractual Stage' in Hartkamp *et al.*, *Towards a European Civil Code* (3rd edn), p. 363.

¹¹ The tort of negligence is commonly used: CA 783/83 *Kaplan v. Novogrotzky* 38 PD(3) 477 (Hebrew); CA 714/87 *Sher v. Cohen* 43 PD(3) 159, 163 (Hebrew). Estoppel is now considered to be embodied within section 12: Friedmann and Cohen, *Contracts A, B, C*, ss. 12.22-12.23 (Hebrew).

¹² Further Hearing 7/81 *Pnidar v. Castro*, 37 (4) PD 673, 701 (Hebrew).

academic writers, however, that the nature of liability is substantially tortious. The law does not specify that the breach of the duty to act in good faith is a tort, but the fact that it is a duty imposed by law, and that the remedy for its breach is reliance damages, makes it close to tort liability.¹³ That means that, for example, punitive damages might be awarded,¹⁴ in particular where the loss was intentionally caused.

The Israeli Supreme Court has interpreted section 12 far beyond its strict wording. Though the sole remedy referred to in section 12 is reliance damages, section 12 has been employed as the basis of an estoppel, in which case the remedy can lead to the enforcement of a non-contractual promise.¹⁵ Also, in a controversial case the Supreme Court has decided that breach of the duty of good faith might lead to the imposition of performance (expectation) damages.¹⁶ The result is that where enforcement or expectation damages are awarded, liability under section 12 becomes contractual.

Evaluation of section 12

The introduction of the duty to act in good faith, in particular in negotiations, has been praised as a major innovation of the Israeli Contracts Law.¹⁷ Section 12 has received attention in the legal literature more than any other section of the Contracts Law.¹⁸ Judicial decisions are saturated with its application. After more than 30 years of operation, one can say that the switch to the continental system is absolute. The cautiousness of English law regarding precontractual liability has been replaced by an expansionist approach resulting in a very wide

¹³ Friedmann and Cohen, *Contracts A, B, C*, s. 12.26. Negligent misrepresentation or fraud entail reliance damages: *ibid.* s. 12.116. But in American law under the dominant approach, fraud entails performance damages: *Restatement Torts 2d* (St. Paul, 1965) s. 549(2) and comment g.

¹⁴ CA 30/72 *Friedmann v. Segal*, 27(2) PD 225 (Hebrew); CA 354/76 *Sharf Estate v. Advisory Economic Services*, 35(2) PD 169 (Hebrew).

¹⁵ CA 846/70 *Atiyah v. Ararat*, 31 (2) PD 780 (Hebrew); CA 829/80 *Shikun Ovdim v. Zepnik*, 37 (1) PD 579 (Hebrew); CTA 7561/01 *Hanit v. Minister of Construction*, 57(3) PD 611, 622 (Hebrew).

¹⁶ CA 6370/00 *Kal-Binian v. A.R.M.*, 56(3) PD 289 (Hebrew); CA 8144/00 *Alrig v. Brender*, 57(1) PD 158 (Hebrew). For a critical note, see G. Shalev, 'More on the Principle of Good Faith' (2003) 3 *Kiryat Hamishpat* (Tel-Aviv) 121 (Hebrew).

¹⁷ CA 800/75 *Kut v. Irgun Hadaiarim*, 31 PD(3) 813 (Hebrew).

¹⁸ For a general survey, see N. Cohen, 'Good Faith in Bargaining and Principles of Contract Law' (1990) 9 *Tel-Aviv University Studies in Law* 249; A.M. Rabello, 'Culpa in Contrahendo and Good Faith in the Formation of Contract: Pre-Contractual Liability in Israeli Law' in Rabello, *Essays on European Law and Israel*, p. 245. For a detailed survey, see Friedmann and Cohen, *Contracts A, B, C*, ch. 12, pp. 511-648.

liability which almost ignores the zone of freedom once assured to the parties during the negotiation process. Israeli courts have applied the principle in the most extremist way possible, probably in a similar way to the Netherlands.¹⁹ This will be evident in the analysis of the cases.

Analysis of cases

In this section a brief account is given of how Israeli law would answer each of the cases in this study: the current position under section 12 of the Contracts Law, but also drawing attention where appropriate to changes in the outcome under section 12 by comparison with the earlier Israeli law (governed mostly by the common law). This commentary has been written in the light of the other countries' reports, and will therefore also highlight comparisons and contrasts with the various European jurisdictions.

Case 1 Negotiations for premises for a bookshop

Cause of action: good faith requires fairness and honesty.²⁰ Starting negotiations implies an intention to conclude a contract.²¹ A did not have such an intention. An Israeli court would impose liability on A by virtue of section 12 and the same result would have ensued before the enactment of the section. The fraudulent misrepresentation by A might well establish also a claim for fraud in torts,²² as in England, Ireland and Scotland.

Loss and remedy: the regular rule of section 12 is that the injured party is entitled to reliance loss. The €0.5 m (the difference between what A offered and the price B received) reflects, however, the possible performance interest of a contract between A and B which has not been concluded. B is not entitled to claim the performance interest. This might be subject to an exception which applies when negotiations reached a stage of no retraction, for example, where the defendant gives an assurance that a contract is going to be concluded, there is an

¹⁹ In particular with regard to the remedy which has been interpreted as including expectation damages: CA 6370/00 *Kal-Binian v. A.R.M.*, 56(3) PD 289 (Hebrew); CA 8144/00 *Alrig v. Brender*, 57(1) PD 158 (Hebrew).

²⁰ HC 59/80 *Beer Sheva Transportation Services v. Labour Tribunal* 35(1) PD 828, 834 (Hebrew) (in the context of good faith in the performance of a contract, but the same applies to the stage of negotiations).

²¹ CA 800/75 *Kut v. Irgun Hadaiarim*, 31 PD(3) 813, 818 (Hebrew).

²² Civil Wrongs Ordinance (New Version) 2 LSI New Version (1972) 5, s.56.

agreement on major points, the injured party substantially relies on it, and later the defendant retracts with no reasonable justification.²³ The regular measure of reliance damages should apply in this case.

Reliance losses could be composed of direct costs (attorney's fees, brokerage fees, etc.), but also of consequential loss such as lost opportunities. In our case, the culpable conduct of A resulted in the loss of the contract opportunity with C. B would be entitled to claim €0.2 m, the difference between the contract opportunity with C and the price he finally received. This result is in conformity with the majority of reports.

A, an intentional wrongdoer, might be subject also to punitive damages.²⁴

Case 2 *Negotiations for renewal of a lease*

Cause of action: similarly to the previous case, A entered negotiations with no intention to conclude a contract. The analysis of the former case is applicable here. Alternatively, since the parties are already contractually connected they are subject to a *contractual* duty of good faith by section 39 of the Contracts Law.

Regarding the contractual duty of good faith, an Israeli court has stated that a party must not misrepresent to the other party his willingness to continue the contractual relations with that other party.²⁵ The duty of good faith implies that as soon as A became aware of B's wish to renew the lease (in July 1999) he should have told him that he was not interested in it. A broke the duty of good faith and also committed the tort of fraud. Tort liability would apply also under the previous law.

Loss and remedies: first, the loss of opportunity with X cannot be attributable to A since B decided that he was not interested in a contract with X before starting negotiations with A. But this can serve as proof of the measure of the actual loss B suffered.

Secondly, the additional costs of renting a temporary warehouse and the business losses which might flow from the disturbance to the distribution arrangement are the actual loss suffered by B. Had B known

²³ Minority view, CA 579/83 *Sonnenstein v. Gabaso*, PD 42(2) 278 (Hebrew), which has become the prevailing view: CA 6370/00 *Kal-Binian v. A.R.M.*, 56(3) PD 289 (Hebrew); CA 8144/00 *Alrig v. Brender*, 57(1) PD 158 (Hebrew), see below n. 56.

²⁴ Friedmann and Cohen, *Contracts A, B, C*, s. 12.131.

²⁵ In the context of an employment contract: HC 566/76 *Elco v. Labour Tribunal*, 31(2) PD 197, 209, 212 (Hebrew).

A's real intention he would have looked for another lease in a convenient area in due time before the expiration of the lease. The fact that prior to the negotiations with A, B was able to find a lease at a price similar to that which he was paying A, might show that the additional costs could have been avoided.

The losses resulting from the move to another location are losses which B might have suffered anyway due to the expiration of the lease, but the present lease is temporary. B might justifiably argue that, had he been notified before, he might have found a permanent place and avoided the temporary lease.

In the contractual measure, B is to be put in the position in which he would have been had the contract not been broken (performance interest). That means that B would probably have saved the costs of the temporary move, the higher rate of the lease and the commercial inconvenience resulting from that move. But the same would apply if the base is precontractual. B is put in the position before starting the negotiations for the renewal of the lease (reliance interest). In that case, B would have started in due time the search for a new lease. As a result, he would probably have saved the costs of the temporary move, the higher rate of the lease and the commercial inconvenience resulting from that move.

Restitution claim for the profits A gained: the misrepresentation made by A enabled him to receive a higher sale price for the property he sold to C. Section 1 of the Law of Unjust Enrichment, 1979²⁶ provides for a duty of restitution if a profit was obtained without legal cause at the expense of another.²⁷ The profit here derived from A's ownership and not from any interest B had in the property.²⁸ B would not be entitled to A's profit from the sale to C.

Case 3 *Mistake about ownership of land to be sold*

Context: A contract for the sale of land needs to be in writing by virtue of section 8 of the Land Law, 1969.²⁹ This section has been interpreted as imposing a substantive requirement,³⁰ without which no contract is formed.

²⁶ 33 LSI 669. ²⁷ Friedmann, *The Law of Unjust Enrichment*, ss. 3.18–3.20 (Hebrew).

²⁸ See generally D. Friedmann, 'Restitution of Benefits Obtained through the Appropriation of Property or the Commission of a Wrong' (1980) 80 *Columbia Law Review* 504, 508.

²⁹ 23 LSI 283. ³⁰ CA 726/71 *Grossman v. Biederman*, 26(2) PD 781 (Hebrew).

Cause of action: a buyer of an interest in land can presumably rely on the statement of an owner that he has the full ownership in the land and negotiate with him on that basis. A did not act fraudulently, but he was negligent. The standard of good faith in Israeli law is objective.³¹ Hence, negligent conduct might give rise to precontractual liability. Alternatively, A might be liable in tort.

This case reflects the swift move Israeli law has made with the enactment of section 12. Though not all the continental states would hold A liable (Germany, for example) Israel would probably join the states which impose liability. Under the previous law, as reflected in the English report, it is doubtful whether liability for negligence would ensue. Liability for negligent misrepresentation was usually imposed in Israel (as in England) when a contract was eventually concluded.³²

Loss and remedy: the losses which B incurred could be attributed to the negligent misrepresentation of A, except for the architect's fees. As long as a contract has not been concluded, expenses resulting from the conclusion of the contract are within the risk of B.

Contributory negligence: as a negotiating party, A owes a duty of care to B, but B ought to act reasonably and to take care of his own interests. B negligently contributed to his losses by not verifying the true ownership. A's liability might be reduced by the principle of contributory negligence whether A is liable in torts,³³ or under section 12. The liability of section 12 is conceived as a species of tort and contributory negligence should naturally apply to it.³⁴ But even if it is regarded as contractual, A's liability might be reduced: Israeli case law has applied contributory fault to contracts as well.³⁵

Case 4 *An architect's preparatory work for a contract which does not materialise; parallel negotiations*

Cause of action: parallel negotiations: freedom in negotiations means that each of the contracting parties might engage in parallel negotiations. This rule, which is the starting point of all reports, was prevalent in Israel before the enactment of section 12. Nowadays it has been made

subject to the following rule: if negotiations have reached an advanced stage, the existence of parallel negotiations should be disclosed to the other party.³⁶ Considering the length of the negotiations and their intensity, B might reasonably expect that the conclusion of the contract is likely. In these circumstances, A might be under a duty by virtue of section 12 to disclose to B in due time the existence of parallel negotiations. B's policy to undertake one commission at a time and not to take part in competitive tendering should not and cannot bind A (even if he knows about it). This conforms to the reports of Germany, Denmark, Norway and Portugal. But if we regard engaging in parallel negotiations as transforming the negotiations into a competitive tender, then by virtue of the duty of section 12 A should notify B about it.

Loss and remedy: if A is liable, B's loss is reflected in the value of his preparatory work to A, at least from the point at which A broke his duty to disclose the fact that he was negotiating with C. Alternatively, B could claim that he lost other contract opportunities. This has to be proved by B. Both possibilities reflect reliance loss. Since B is engaged in one commission at a time, it is doubtful whether he could claim for both the preparatory work done for A and the loss of another opportunity.

Cause of action: precontractual expenditure: the crucial point is what was the understanding between the parties and whether the starting point is contract (no liability absent a final contract) or restitution (liability for services rendered). Professional norms might clarify the matter, but they are not easy to prove and do not always exist.

Israeli case law is not unanimous. In one case, liability to pay (based on restitution and on an implied preliminary contract) for preparatory work made by an architect was imposed, though a final contract was not eventually concluded.³⁷ This is in line with the minority reports (Finland and the Netherlands). In another case liability was imposed by virtue of section 12: the duty of the party who received the work was to tell the architect that he was not willing to pay.³⁸ But in another case the presumption of remuneration did not apply, and no liability ensued, mainly because negotiations were in a preliminary stage, and

³¹ CA 6339/97 *Roker v. Salomon*, 55(1) PD 199 (Hebrew); Friedmann and Cohen, *Contracts A, B, C*, ss. 12.44-12.45.

³² See, e.g., CA 76/86 *Amidar v. Aharon*, 32(2) PD 337 (Hebrew); below n. 100.

³³ Friedmann and Cohen, *Contracts A, B, C*, s. 12.133.

³⁴ CA 590/88 *Abraham Rubinstein v. Fisher*, 44(1) PD 730 (Hebrew).

³⁵ CA 3912/90 *Eximin SA v. Textile and Shoes Ital Style Ferrari*, 47(4) PD 64 (Hebrew). For a thorough analysis, see Porat, *The Defense of Contributory Fault in Contract Law*.

³⁶ Friedmann and Cohen, *Contracts A, B, C*, s. 12.83. See CA 144/87 *Ingeener Faber v. State of Israel*, 44(3) PD 769 (Hebrew), where such a duty of disclosure was imposed.

³⁷ CA 474/80 *Gruber v. Tel-Yossef*, 35(4) PD 45, 59 (Hebrew); Friedmann and Cohen, *Contracts A, B, C*, s. 12.83.

³⁸ CA (Haifa) 2547/82 *Almagor v. Achilhood*, PM 1986(3) 430, 437 (Hebrew).

the parties were to be bound only by a formal agreement.³⁹ This reflects the majority of reports.

Loss and remedy: if liability for precontractual expenditure is grounded in restitution, A would have to restore the benefit he received, namely the value of the work done or the reasonable fees B would be entitled to. The same would apply if liability is grounded in contract or in section 12. Since B is engaged in one commission at a time, it is doubtful whether he could claim for both the preparatory work done for A and the loss of another opportunity.

Case 5 *A broken engagement*

Position of a promise of marriage or engagement: a promise of marriage is considered a contract and in that sense is not a ground of precontractual liability. But since it is a preparatory step preceding marriage itself (which is considered under Israeli law a contract) it might pertain to the precontractual stage.

Though it has a binding force, a promise of marriage is weaker than a regular contract. Obviously, it is not enforceable⁴⁰ and the damages for its breach are reliance and not performance damages.⁴¹ For many years, Israeli case law treated the claim for breach of this promise as repulsive and called on the legislature to abolish it.⁴² A recent Supreme Court case, *Plonit*, awarded damages for pain and suffering to a woman whose lover, a married man, broke his promise to divorce his wife and marry her.⁴³ This has changed the previous law under which a promise given by a married person was void as against public policy.⁴⁴ At a time when the actionability of such a promise is being abolished or limited (England, Ireland, Scotland, the Netherlands, Norway), the Israeli

³⁹ CA 739/86 *Shem-Oor v. Municipality of Kiriath Gat*, 44(2) PD 562 (Hebrew).

⁴⁰ Also for the purpose of the tort of inducing breach of contract in Civil Wrongs Ordinance (New Version), s. 62, a promise of marriage is not considered a contract: Motion 1380/72 (Jerusalem) *Rosenberg v. Chazan*, PM 1974(1) 469 (Hebrew).

⁴¹ CA 171 473/75 *Ron v. Chazan*, 31(1) PD 40 (Hebrew).

⁴² E.g. CA 647/89 *Shifberg v. Avtalion*, 46(2) PD 169 (Hebrew).

⁴³ CA 5258/98 *Plonit v. Almoni*, 58(6) PD 209 (Hebrew).

⁴⁴ CA 337/62 *Reisenfeld v. Yakobson*, 17 PD 1009 (Hebrew); CA 563/65 *Ieger v. Palevitz*, 20(3) PD 244 (Hebrew). This rule was subject to two exceptions. First, where the promisor concealed his/her marriage; the claim is based on fraud: CA 609/68 *Natan v. Abdalla*, 24(1) PD 455 (Hebrew); CA 386/74 *Plonit v. Almoni*, 30(1) PD 383 (Hebrew). Secondly, where it could be proved that at the time the promise was given the marriage had already broken down: CA 337/62 *Reisenfeld v. Yakobson*, 17 PD 1009 (Hebrew); CA 563/65 *Ieger v. Palevitz*, 20(3) PD 244 (Hebrew).

Supreme Court's expansion of its scope is dubious.⁴⁵ This is in line, however, with the expansion of precontractual liability in general.

Loss and remedy: expenses: A, who broke the engagement one day before the ceremony and seemingly with no justifiable ground, is liable under Israeli law for the breach. B is entitled to damages for the expenses he incurred and also to non-pecuniary damages for pain and suffering.

Engagement ring: the issue is covered by the law of restitution, influenced by the contractual surrounding. The ring was given at the beginning of the engagement. In the context of engagement gifts, the assumption (which can be rebutted) is that the gifts are conditional.⁴⁶ By its very definition the ring was given on the assumption that marriage is to follow. With the non-occurrence of the condition, A is bound to restore it to B.⁴⁷

Case 6 *An express lock-out agreement*

Agreement regulating the negotiations: the principle of freedom of contract allows negotiating parties to conclude a contract regulating their negotiations.⁴⁸ Israeli case law has recognised the validity of a contract to negotiate even before the enactment of the Contracts Law,⁴⁹ at a time when such a contract was not recognised in England,⁵⁰ and where no general principle of good faith in negotiations existed in our system.

Express lock-out agreement: this is a definite lock-out agreement which is recognised even in England.⁵¹ By negotiating with C after two months, A broke the contract with B. Prior to that, A and B reached an agreement regarding the price (€2 m) but no contract was concluded

⁴⁵ For a detailed survey, see O. Groskopf and S. Halabi, 'A Breach of a Promise of Marriage' in Ben-Naftali and Naveh, *Trials of Love*, p. 107 (Hebrew); N. Cohen, 'The Fall and the Rise of a Promise of Marriage' (2005) 11 *Hamishpat* 27.

⁴⁶ Friedmann, *The Law of Unjust Enrichment*, s. 25.71 (Hebrew).

⁴⁷ On the history of the duty to restore (or not) the engagement ring in American law, see R. Tushnet, 'Rules of Engagement and Rings' (1998) 107 *Yale Law Journal* 2583; on the New York law providing for the return of the ring with the breaking of the engagement, see A. Glassman, 'I do! Or do I? A Practical Guide to Love, Courtship, and Heartbreak in New York: or Who Gets the Ring Back Following a Broken Engagement' (2003) 12 *Buffalo Women's Law Journal* 47.

⁴⁸ Contracts Law, s. 24, provided the contract is not immoral, illegal or contrary to public policy (Contracts Law, s. 30).

⁴⁹ CA 615/72 *Gelner v. Haifa Municipal Theater*, 28(1) PD 81 (Hebrew).

⁵⁰ *Courtney & Fairbairn Ltd v. Tolaimi Bros (Hotels) Ltd* [1975] 1 WLR 297, 301. This case rejected the approach in *Hillas v. Arcos* (1932) 147 LT 503, 515, which gave effect (in an obiter dictum) to such an agreement.

⁵¹ *Pitt v. PHH Asset Management Ltd* [1994] 1 WLR 327.

because of other outstanding matters. Israeli courts tend to anticipate contractual liability, in particular where there is an agreement on the price, even though only a preliminary agreement has been achieved. The missing points are filled in by reference to the contractual default rules.⁵²

Loss and remedies: enforcement and injunction: if the court finds here an agreement, B might be awarded €1m: the difference between the agreed price (€2m) and the price A received from C. Assuming that no contract is found, B lost the contract opportunity with A. He also incurred expenses: accountants' and lawyers' fees. It seems unlikely that a contract to negotiate will be *enforced* because of its personal character. But an *injunction* might be issued against A to refrain from negotiating with C. This could lead to the 'annulment' of the breach and to enabling the parties to keep negotiating.⁵³ Negotiations might succeed if B is given the right to buy the business on the same conditions and at the same price that A was willing to sell to C⁵⁴ (similar to the Norwegian approach).

Damages: reliance losses, namely accountants' and lawyers' fees, would be allowed by most systems. But B might be awarded damages reflecting his chances of having the contract with A,⁵⁵ as in England, France, Italy, the Netherlands, Norway, Scotland and Switzerland.

An Israeli Supreme Court case which dealt with an agreement to negotiate between a director and a theatre went even further. The court awarded the director damages reflecting his future earnings and loss of other opportunities. This case, which predated section 12, treated the contract to negotiate as if it were fully binding (probably due to the contracts that had been entered into in the past between the parties). To this one should add the willingness of Israeli courts to grant performance damages to the injured party where the negotiations have reached

an advanced stage and there has been an agreement on the price.⁵⁶ If this is applied, the court might use the sum agreed by the parties as the binding price, and B's damages would be €1m, the difference between €2m (his price) and €3m (the price that A received from C). This would be the most far-reaching result among all systems.

Restitution: was A enriched at the expense of B by breaking the contract with B and receiving €3m from C (which, but for the breach, B could have obtained)? B had merely a contractual expectancy not a full contractual right. As with the remedy of damages, also here one could rely on B's chances of obtaining the contract in the absence of A's breach.⁵⁷

Agreement to negotiate in good faith: an agreement to negotiate in good faith is valid in Israeli law. It exemplifies the shift from the common law, where such a contract is not recognised,⁵⁸ to the civil law, where it is recognised. It reiterates the duty imposed *ex lege* by section 12, fortifies it (similarly to Swiss law) and transforms it into a contractual duty stemming from section 39 of the Contracts Law. Breaking off negotiations without reasonable cause might be a breach of the duty of section 12 as much as it can be a breach of the contractual duty which the parties voluntarily assumed. Following the tendency of Israeli courts to impose contractual liability, in particular where there is an agreement on the price, the result might be that A was in breach of a contract.

If no valid contract was concluded, a better offer seems to be a reasonable cause for breaking off negotiations. Good faith does not limit A's right to negotiate with others (case 4), provided that the contact between the parties did not reach the point of no retraction.⁵⁹

As soon as the agreement is concluded with C, A should notify B about it. In the present case there is no mention of a delay by A. Therefore, A should not be liable for the expenses B incurred.

⁵² See generally Friedmann and Cohen, *Contracts A, B, C*, ch. 8, especially ss. 8.6–8.21 for cases where a preliminary agreement was regarded as binding and was completed by default rules. see CA 1049/94 *Dor Energy v. Hamdan*, 50(5) PD 820 (Hebrew); CA 3102/95 *Cohen v. Cohen*, 49(5) PD 739 (Hebrew); CA 3026/98 *Cohen v. Irmiahoo* (2001) (Hebrew) (not yet published).

⁵³ N. Cohen, 'Pre-Contractual-Duties: Two Freedoms and the Contract to Negotiate' in Beatson and Friedmann, *Good Faith and Fault in Contract Law*, pp. 25, 48.

⁵⁴ This approach of awarding the defaulting party the best option he could get, was applied in CA 1049/94 *Dor Energy v. Hamdan*, 50(5) PD 820 (Hebrew) following Friedmann and Cohen, *Contracts A, B, C*, s. 8.21.

⁵⁵ Cohen, 'Pre-Contractual-Duties', above n. 53, p. 49.

⁵⁶ CA 6370/00 *Kal-Binian v. A.R.M.*, 56 PD(3) 289 (Hebrew); CA 8144/00 *Alrig v. Brender*, 57(1) PD 158 (Hebrew). For a more cautious approach limiting the remedy to reliance damages, see CA 10385/02 *Machness v. Regency Investments*, 58(2) PD 53 (Hebrew).

⁵⁷ Cohen, 'Pre-Contractual-Duties', above n. 53, p. 50. A similar question arises with regard to C. If C were aware of the contract between A and B, he might be regarded as committing the tort of inducing breach of contract, and as benefiting from the wrong: *ibid.*

⁵⁸ *Walford v. Miles* [1992] 2 AC 128.

⁵⁹ CA 6370/00 *Kal-Binian v. A.R.M.*, 56 PD(3) 289 (Hebrew); CA 8144/00 *Alrig v. Brender*, 57(1) PD 158 (Hebrew).

Case 7 Breakdown of merger negotiations

Context: this case raises the proper limits of contractual, precontractual and non-liability rules. In the past, Israeli negotiating parties had the power to retract up to the point where the contract was concluded. Before that, no liability was imposed unless a tort had been committed. This approach, which characterises the common law (English, Irish, Scots reports), has been changed with the introduction of the duty of good faith to negotiations. Liability has expanded and starts at a point where, in the light of the intensity of the negotiations and the expectations that were created during it, retraction is in breach of good faith.⁶⁰

Situation 1. Breaking off after three years with no agreement on major points: merger negotiations seem naturally to be lengthy and complicated. Three years of intense negotiations might not be exceptional. After three years where no agreement was made it does not seem unreasonable to put an end to the negotiations. A should not be liable either if it gives one of the three reasons, or if it does not give any reason at all. Both parties incurred expenses during this time. This is the natural risk of negotiations. The same holds true if the withdrawal is a result of a recession.

But if A knew of reasons for withdrawal a year before it actually broke off negotiations, it went on with the negotiations with no real intent to conclude a contract. This is a breach of the duty of good faith.⁶¹ A should be liable for the reliance losses which B incurred from the time it should have notified B about the contract with C.

Situation 2. Breaking off after a short time of negotiations with agreement on all major points: under Israeli law, a preliminary agreement, even subject to contract, might create a binding contract, if the parties agreed on all major points,⁶² unless the parties expressly stated that the contract is binding only if they agree on the missing minor points. If agreeing on the minor points were not a condition, retraction by A for whatever

⁶⁰ CA 6370/00 *Kal-Bintan v. A.R.M.*, 56 PD(3) 289 (Hebrew). ⁶¹ See cases 1 and 2.

⁶² For cases where a preliminary agreement was held to be a contract with default rules as gap-filler, see CA 1049/94 *Dor Energy v. Hamdan*, 50(5) PD 820 (Hebrew); CA 3102/95 *Cohen v. Cohen* 49(5) PD 739 (Hebrew); CA 3026/98 *Cohen v. Irmiahoo* (2001) (Hebrew) (not yet published). Most cases have related to a contract for the sale of land, but not all of them: e.g., *Dor Energy v. Hamdan* (operation of a gas station).

reason would be regarded a breach of contract (similarly to Spain and Switzerland).⁶³

Alternatively, A might be subject to precontractual liability. When the parties agreed on all major points, the negotiations came to the point of no retraction, unless A had a reasonable ground for breaking them off.⁶⁴ A better offer from C might not be considered as a good reason if negotiations had reached the point of no retraction. In such a stage, parallel negotiations are beyond the risk of the parties.⁶⁵ An insurmountable cultural difference might be regarded as a good reason. If A cannot afford the merger because of an abrupt change, this might be regarded as a reasonable ground, but not if A could have known it earlier.

Situation 3. A assured B that an agreement would be reached: such assurances have an ambiguous character: they might be either a mere expression of hope in the success of negotiations (Italy, Sweden), or create a contract to negotiate in good faith under which A would not be liable only if it had a reasonable ground for breaking off negotiations, as discussed above. Israeli courts would tend to impose liability on that ground.

Loss and remedies: as pointed out earlier,⁶⁶ section 12 has been expanded to include performance damages and enforcement. Enforcement is unlikely due to the personal character of the contract. Where the negotiations have reached an advanced stage, and the contract was not concluded only due to the breach of good faith, performance damages might be awarded (similar to the strong remedy in the Netherlands).⁶⁷

Case 8 A shopping centre without a tenant

Cause of action: this case demonstrates again the tension, reflected in the division of opinions in the reports, between the freedom not to be bound by an unwanted contract and the duty to act in good faith during negotiations. Following section 12, and the tendency of Israeli courts to expand liability, Israel is likely to join the jurisdictions that hold A liable.

A should have made the survey before B started the construction. At least, it should have notified B that his tenancy is subject to the survey. It did none of this. A's conduct amounted to a promissory representation that a contract was going to be concluded. A is liable for the loss B incurred in reliance on A.

⁶³ Claiming either reliance damages or performance damages is the option of the party injured by a breach of contract: CA 3666/90 *Hotel Zukim v. Municipality of Natania*, 46(4) PD 45 (Hebrew).

⁶⁴ Friedmann and Cohen, *Contracts A, B, C*, s. 8.42. ⁶⁵ See cases 1 and 4.

⁶⁶ See cases 1, 4 and 6. ⁶⁷ CA 6370/00 *Kal-Bintan v. A.R.M.*, 56 PD(3) 289 (Hebrew).

Promissory estoppel was part of Israeli law before section 12, though its scope was not certain.⁶⁸ It was not clear whether it could be used as a sword or only as a shield.⁶⁹ Therefore, it is doubtful whether B's claim on the basis of promissory estoppel could succeed in the past (as indicated in the English report). After the enactment of section 12, promissory estoppel has been independently used not only as a shield but also as a sword.⁷⁰ Alternatively, it can be regarded as being incorporated in section 12.⁷¹ In any case, A's denying the expectation it created is contrary to good faith: A broke off negotiations at the stage of no retraction with no reasonable excuse (France and Netherlands).

Loss and remedies: the regular remedy is reliance damages. If the shopping centre would not have been built but for the negotiations with A, A might be liable for the construction cost. But this is subject to the rule of mitigation. If B is able to find another flagship store or make another use of the building, his losses might accordingly be reduced.

If the loss results not from the very construction, but from the adaptation of the building to the needs of A, A is liable for the cost of re-adaptation to another potential tenant.

Although A is liable for the loss which B incurred, B, as a professional, might be regarded as negligently contributing to his loss.⁷² He should have verified that A was indeed going to be his tenant (similarly to Finland, France, Portugal, Switzerland).

If A gave an assurance, B's case is stronger, and A might be fully liable.

Case 9 Breakdown of negotiations to build a house for a friend

Context: does the understanding between friends, where B supplies building services on A's land and A is to pay a price lower than the normal commercial price, amount to a fully binding contract? Are there

any alternative grounds of liability based on restitution or the principle of good faith in negotiations?⁷³

Contractual liability: usually, the price is a decisive factor in a contract and its absence might indicate that no contract was ever concluded. Israeli legislation contains, however, a default rule regarding the price, whereby the appropriate price should be paid.⁷⁴ Our case seems to suit the application of this section. A was willing to receive the services of B. The services were supplied. A was aware that the services are not to be given free. Both parties agreed that the price is going to be below the commercial price. This is the basis for the completion of the contract and for A's liability (similar to the Irish, Norwegian, Swedish reports).⁷⁵

Restitutionary liability: this is a borderline case between contract and restitution. An important category of unjust enrichment, which covers the case, is where a benefit was bestowed upon someone following his request.⁷⁶ The benefit was given to A – not gratuitously – following his request or at least his approval. Holding the benefit without paying for it establishes an unjust enrichment at the expense of B. In measuring the enrichment, the court should take into account the understanding between the parties that the fees are going to be below the market price. This renders A's restitutionary liability the same as his contractual liability.⁷⁷

Precontractual liability: A's conduct might be regarded as acquiescence. By not stopping B, or by not notifying him immediately of his exact financial position, he broke his duty to act in good faith during negotiations.⁷⁸ A is liable to B for his reliance losses, namely for the expenses

⁶⁸ N. Cohen, 'Good Faith in Bargaining and Principles of Contract Law' (1990) 9 *Tel-Aviv University Studies in Law* 261-3; Friedmann and Cohen, *Contracts A, B, C*, ss. 12.19-12.21.

⁶⁹ CA 285/75 *Singer v. Kimelman*, 30(1) PD 804 (Hebrew).

⁷⁰ Friedmann and Cohen, *Contracts A, B, C*, ss. 12.22-12.23, following s. 90 of the *Restatement Contracts 2d*. There is a vast literature on this section. See K. Teeven, 'The Advent of Recovery in a Market Transaction in the Absence of a Bargain' (2002) 39 *American Business Law Journal* 289; G. Duhl, 'Red Owl's Legacy' (2003) 87 *Marquette Law Review* 297 and references in n. 85 in that article.

⁷¹ Friedmann and Cohen, *Contracts A, B, C*, ss. 12.22-12.23. Cf. CA 2071/99 *Panti v. Izhary*, 55(2) PD 721 (Hebrew) where precontractual liability was imposed on a seller who let the buyer make building plans regarding the parcel to be sold, and then retracted. See below n. 129.

⁷² See case 3.

⁷³ Land Law, 1969, s. 21, regulates the case of building on another's property, but the section applies where the building was made without an agreement with the owner of the property. Probably the consent of the owner to the building suffices for the purpose of this section.

⁷⁴ Contracts Law, s. 46, states that absent an agreement on the price, the appropriate price according to the circumstances at the time the contract was made should be paid. A frequent case where fees are awarded irrespective of the absence of an agreed price is in the context of attorney and client. The award is based either on contract or on restitution: CA 525/81 *Gazit v. Rozen*, 36(2) PD 337 (Hebrew); CA 136/92 *Beinish-Adiel v. Dania* 47(5) PD 114 (Hebrew); CA 499/89 *Ramat-Avivim v. Miron*, 46(4) PD 586 (Hebrew).

⁷⁵ Friedmann and Cohen, *Contracts A, B, C*, s. 8.18.

⁷⁶ Friedmann, *The Law of Unjust Enrichment*, ch. 8, ss. 8.1-8.18 (Hebrew).

⁷⁷ Friedmann and Cohen, *Contracts A, B, C*, s. 12.142.

⁷⁸ CA (Haifa) 2547/82 *Almagor v. Ahihud*, PM 1985(3) 430 (Hebrew) (in an architect's claim for fees for work done the court held that the client had to remove the vagueness regarding the relations with the architect); above n. 38; Friedmann and Cohen, *Contracts A, B, C*, s. 12.142.

B incurred taking into account the fact that A was ready to do the work for a reduced profit.

This result renders precontractual liability similar to both contractual and restitutionary liability. The same result would have ensued under the former law since liability might be grounded in contract or restitution. This is also evident in the reports where virtually all the states (with the possible exception of Denmark) would hold A liable.

Case 10 Public bidding

Bidding rules: the procedure for public bidding is a well-known application of the rules of offer and acceptance, which has also been adopted by Israeli case law. By the advertisement the employer (A) is making an invitation to the public to submit offers; the bidders are the offerors; the acceptance is made by the employer,⁷⁹ and it is up to it to determine the mode of acceptance.

It is quite common for the employer to state in the bidding conditions that it is not bound to accept any offer.⁸⁰ But A took upon itself the obligation to conclude a contract with the lowest bidder.

The bidding rules create relations between the employer and each bidder, and between the bidders *inter se*. Similarly to France, Italy, the Netherlands and Switzerland, they are based either on a contract which relates to the bidding procedure or on the duty of good faith in negotiations.⁸¹

B is the lowest offer but contract is given to C; A failed to consider B's bid: contractual liability is not based on fault. A's conduct amounts to a breach of a contractual duty. The precontractual liability by virtue of section 12 is based on fault. Presumably, A did not consider B's bid due to negligence. This amounts to a breach of the duty. Due to the fact that the basis of liability might be contractual, the same result would have ensued under the former law.

A always intended to give the contract to C: A maliciously broke the duty to consider B's and the other participants' offers seriously, grounded

either in contract or in section 12.⁸² A broke the contractual duty to award the contract to B. A might be liable also in torts, for committing fraud: it fraudulently induced the bidders to participate in a procedure which it did not intend to follow. The same result would have ensued under the law before section 12 was enacted.

Loss and remedies: B lost the bargain to which it was entitled. Enforcement (including injunction) is the primary remedy in Israel for breach of contract.⁸³ An injunction against A (and C) might lead to the annulment of the contract with C and the enforcement of B's contractual right.⁸⁴ Otherwise, B is entitled to performance damages for the loss of profits from the contract with A.⁸⁵ The same result ensues if the breach is of the duty of good faith. Though the usual remedy is reliance damages, B has the right to sue also for the loss of the bargain with A, to which it was entitled.

B, who was not the lowest bidder, was not considered due to an error: B had the right to be considered either under the collateral contract regulating the bidding or by the rules of good faith. A broke the contract or the duty of good faith. This applies also in the case where A is a public authority. But B, not being the lowest bidder, did not suffer any loss. Hence, at most B might be entitled to nominal damages.⁸⁶

Public authority: a public authority is, as a rule subject to exceptions, bound by a statutory law to have a bidding procedure as a mechanism of concluding its contracts.⁸⁷ The rules applying to A as a private employer would *a fortiori* apply where A is a public authority. A public authority is under a duty to consider all the bidders seriously and to treat them

⁷⁹ CA 207/79 *Raviv v. Bet Yules*, 37(1) PD 533, 542, 546 (Hebrew) (which was overruled in Further Hearing 22/82 *Beit Yules v. Raviv*, 43(1) PD 441(Hebrew), but not on this point); Friedmann and Cohen, *Contracts A, B, C*, s. 7.38.

⁸⁰ As was done in CA 207/79 *Raviv v. Bet Yules*, 37(1) PD 533 (Hebrew).

⁸¹ CA 207/79 *Raviv v. Bet Yules*, 37(1) PD 533 (Hebrew); Further Hearing 22/82 *Beit Yules v. Raviv*, 43(1) PD 441 (Hebrew).

⁸² Cf. cases 1 and 2. C might also be liable for breach of the duty of good faith or for inducing A to break the contract regulating the bid: CA 207/79 *Raviv v. Bet Yules*, 37(1) PD 533, 553 (obiter dictum) (Hebrew).

⁸³ Remedies Law, s. 3. ⁸⁴ See case 6.

⁸⁵ B also has the option to sue for reliance damages: CA 3666/90 *Hotel Zukim v. Municipality of Natania*, 46(4) PD 45 (Hebrew).

⁸⁶ By virtue of s. 13, which grants the court discretion to impose compensation for non-pecuniary loss and which applies by s. 12(b) to the measure of damages for breach of s. 12(a); above n. 8.

⁸⁷ Mandatory Tenders Law, 1992 (no official translation exists) which provides in s. 2 that the state and any governmental corporation is under a duty to conclude a contract only by a public tender which gives an equal opportunity to any person to take part in it. But the Law also provides for many exceptions (ss. 3B and 4). By virtue of this law there is a detailed regulation in Regulations of the Mandatory Tenders, 1993; reg. 21 states that the committee in charge of the bidding has a power to select the most appropriate offer or to decide that it does not select any offer. This power not to select should be employed reasonably: AAA 8328/02 *B. Yair v. Arim*, 58(1) PD 145 (Hebrew).

equally.⁸⁸ It has to obey the legal and contractual rules which apply to the procedure. In our case, A was under a duty to consider B and to conclude the contract with it.⁸⁹

Case 11 A contract for the sale of a house which fails for the lack of formality

Requirement of formality: a contract for the sale of land must be in writing by virtue of the Land Law.⁹⁰ This requirement has been interpreted as substantive.⁹¹ This interpretation has led to a series of cases invalidating 'contracts' for the sale of land when the documents which accompanied the contracts did not include sufficient details.⁹² The Supreme Court has since given a narrower interpretation to mitigate the harsh consequences of the substantive requirement. Thus, a receipt with scant elements of agreement has been regarded as a binding contract for the sale of land.⁹³ Also, a preliminary agreement, subject to contract, hand-written on a notebook and bearing no signatures, has been regarded as a binding contract for the sale of land.⁹⁴

Conflict between formality and fairness: where no written document exists, Israeli courts have occasionally applied section 12 to mitigate the formal requirement, in particular where there was a substantial

⁸⁸ The principle of equality is not applied to a private bidding. That means that a private employer can decide not to conclude a contract with either bidder, and to start negotiating only with one of the bidders in order to conclude a contract with him. This was decided in Further Hearing 22/82 *Beit Yules v. Raviv*, 43(1) PD 441 (Hebrew). In that case the employer did not bind itself to conclude a contract following the bidding.

⁸⁹ CA 700/89 *Electricity Company v. Malibu*, 47(1) PD 667 (Hebrew), where in a public bidding the party who should have won the contract was awarded performance damages. It was held that the grounds of liability, apart from s. 12, are the following: an independent administrative cause of action; a collateral contract; and negligent misrepresentation.

⁹⁰ See case 3. ⁹¹ CA 726/71 *Grossman v. Biederman*, 26(2) PD 781 (Hebrew).

⁹² E.g. CA 285/75 *Singer v. Kimelman*, 30(1) PD 804 (Hebrew), where the written agreement for the sale of an apartment consisted only of a receipt signed by the seller, confirming that he had received an advance payment and mentioning (not clearly) the price of the apartment. The seller allowed the buyer to enter the apartment and to prepare it for her occupancy. When the time came to pay the balance of the price, the seller refused acceptance, claiming that there was no binding agreement in writing. The Supreme Court held that the requirement of a substantive document was not fulfilled. See below n. 97.

⁹³ CA 235/75 *Kadri v. St Charles Convent*, 30(1) PD 800 (Hebrew).

⁹⁴ CA 692/86 *Botkovsky v. Gat*, 44(1) PD 57 (Hebrew). For a survey, see Cohen, 'Good Faith in Bargaining and Principles of Contract Law', above n. 68, pp. 279-87.

performance of the contract.⁹⁵ In a case where there was actually completed performance, the court enforced the contract against the seller, stating that the combination of fault and reliance might override the lack of formality.⁹⁶ Before the enactment of section 12, the court was more cautious and gave predominance to the formal requirement.⁹⁷

Case under consideration: B did not rely on the existence of a contract. The parties did not perform the contract. The stage is preliminary, and the expenses B incurred (agent's fees and travel expenses) seem to be part of the negotiations and not of the performance. B did not know about the requirement, but it is likely that A did not know about it either, and only when he realised that the agreement was not final did he make use of the 'let-out' and renege. On the face of it, neither party is at fault, and so each should bear his own expenses.

A knew of the formality requirements: if A did not know that B was unaware of the requirement, it is doubtful whether he should have informed B about it.⁹⁸ They both had the right to renege as long as a formal contract had not been concluded. If, however, A knew that B was unaware of the formal requirement and kept silent in order to be able to renege, A might be held to have breached the duty of good faith. Probably under the previous law, A would not have been liable. Tort law does not give a claim for failure to disclose⁹⁹ (see the English report).

A is a professional: being a professional (for example, in the construction business) imposes a duty upon A to take care to comply with the formal requirement. Not doing this might be considered as fault and breach of the duty of good faith. Under the previous law, it is not clear whether tort law would impose liability for a mere failure to disclose¹⁰⁰

⁹⁵ CA 651/82 *State of Israel v. Eilat Company*, 40(2) PD 785 (Hebrew).

⁹⁶ CA 986/93 *Kalmar v. Guy*, 50(1) PD 185 (Hebrew).

⁹⁷ In CA 285/75 *Singer v. Kimelman*, 30(1) PD 804 (Hebrew), above n. 92, the buyer claimed that the doctrine of promissory estoppel should apply, thereby forcing the seller to perform his promise. The Supreme Court held that since this doctrine stood in sharp contradiction to s. 8 of the Land Law (providing for a written document) it could not be applicable. But it ruled that the buyer was entitled to damages for the expenses she incurred, which were spent with the approval of the seller.

⁹⁸ CA 838/75 *Spector v. Zarfati*, 32(1) PD 231 (Hebrew): no duty of disclosure when one party did not know about the mistake of the other party.

⁹⁹ Friedmann and Cohen, *Contracts A, B, C*, ss. 12.63-12.66.

¹⁰⁰ Cf. CA 76/86 *Amidar v. Aharon*, 32(2) PD 337 (Hebrew), where a new immigrant approached a public housing corporation to rent a space for operating a locksmith's store. The contract contained a clause to the effect that the store could only be used for such a purpose. It turned out that the municipality did not license the store for

(see the English report which does not differentiate between the two situations).

A misled B about the requirement of formality: the fault of A is clear. But for his conduct, the contract would have been duly concluded. This should make him liable towards B either in tort or on the basis of section 12. This would have been the result also under the former law (see the English report).

Loss and remedies: the usual remedy for breaching the duty of good faith in negotiations is reliance damages. But if conclusion of the contract was prevented only due to the bad faith of a party to the negotiations, the injured party might be awarded enforcement or performance damages.¹⁰¹ In the case where A misled B, the remedy of enforcement or performance damages should be considered.¹⁰²

The expansive liability in Israel is therefore evident again: A would be liable in the last two cases (as in Germany, Italy, Norway) with some probability of liability also in the first case (as in Austria and France).

Case 12 Confidential design information given during negotiations

Context: confidential information and trade secrets: confidential information is often referred to as a quasi-proprietary right.¹⁰³ It has long been protected by the rules of breach of confidence, rooted in equity, which were absorbed in our legal system.¹⁰⁴ Confidential information might be protected in the sphere of negotiations, but its ambit is much wider.

As in many other jurisdictions, in Israel this area is governed by a special statute: the Commercial Wrongs Law, 1999,¹⁰⁵ which gives remedies additional to those provided by the general law.

that purpose. Though the contract included an exemption clause to the effect that the corporation was not liable for failure to obtain the necessary licence, the court imposed on it liability for negligent misrepresentation. The court put emphasis on the inequality between the parties: the new immigrant and the professional corporation. But the case dealt with a misrepresentation, not with a mere failure to disclose.

¹⁰¹ CA 6370/00 *Kal-Binian v. A.R.M.*, 56 PD(3) 289 (Hebrew).

¹⁰² Cf. CA 481/81 *Tabulitzky v. Perelman*, 38(4) PD 421 (Hebrew), where a seller agreed to sell an apartment to the buyer. Before signing the contract the seller assured the buyer that a storage room was part of the apartment. In fact, the seller knew that it had already been sold to somebody else. Though not included in the written agreement, the court awarded the buyer the value of the storage room, thus giving a binding force to the oral promise. The basis of liability was tort law.

¹⁰³ HC 1683/93 *Yavin Plast v. National Labor Tribunal*, 47(4) PD 702 (Hebrew).

¹⁰⁴ CA 649/74 *Polistick v. Cegecol*, 29(2) PD 397 (Hebrew).

¹⁰⁵ No official translation exists.

Application: disclosing essential information during negotiations is typical¹⁰⁶ and is often essential to the negotiations, but it is limited and is not coupled with a licence to use it if negotiations fail. Where the nature of the information is intrinsically secret, the owner need not expressly state that it is confidential. It should be regarded as part of the understanding between the parties. When A passed on to C the confidential information without B's consent, he committed a clear breach of the duty of confidentiality.

Causes of action: A clearly committed the tort of conversion under the Law of Commercial Wrongs, and is also liable by virtue of the general principles of law, in particular section 12. Similarly to the position described in many of the country reports, A's conduct amounts to a breach of the duty of good faith.

Loss and remedies: B is entitled to damages for the loss he incurred. Also, by virtue of section 13 of the Law of Commercial Wrongs, the court might impose on A damages at a certain sum specified by the law even without proving loss. An injunction might be issued against both A and C¹⁰⁷ (see the English, French and Scottish reports), and A might be liable in restitution (as in many other jurisdictions) for the profits he has made at B's expense.¹⁰⁸

Case 13 Misrepresentation or silence about a harvester's capacity

Context: this is not a case of failed negotiations or of a failed preparatory contract.¹⁰⁹ Following the statement by A, a contract was concluded between A and B. The statement by A can be either a precontractual statement (a misrepresentation) or a contractual warranty. This might have an impact on the remedies to which B is entitled. Israeli courts tend to allow the plaintiff to claim alternatively, either on the misrepresentation or on the contract.¹¹⁰

¹⁰⁶ For references in American law dealing with information and ideas transferred during negotiations which failed, see 9 *American Law Reports* 3d 665 (New York, 1966). Cf. also the Canadian case of *LAC Minerals v. International Corona Resources* (1989) 61 DLR (4th) 14 (the owners of the information were entitled to a constructive trust on its use).

¹⁰⁷ C might be liable as well if he were aware of the breach. But even if he acquired it bona fide he might be held liable under Commercial Wrongs Law, s. 8.

¹⁰⁸ Which could be a quantum meruit for the use made by B's information: CA 649/74 *Polistick v. Cegecol*, 29(2) PD 397 (Hebrew).

¹⁰⁹ Cf. cases 5 and 10.

¹¹⁰ For a distinction and an analysis of the whole issue: Friedmann and Cohen, *Contracts A, B, C*, ss. 15.78-15.91.

Causes of action: the statement that the machine would be able to harvest one acre a day is a precontractual misrepresentation by which the contract was induced. The contract was entered into by a mistake for which A was responsible, either fraudulently or negligently. This is a breach of good faith in negotiations.¹¹¹ Negligent or fraudulent misrepresentation also constitutes a tort. This obtained prior to the enactment of section 12.

Alternatively, A took upon himself an undertaking regarding the machine's quality. A contract of sale is subject, unless agreed otherwise, to the implied provisions of the Sale Law, 1968,¹¹² which states in section 11 that a seller does not fulfil his obligation if he has delivered 'property lacking the quality or characteristic necessary for its ordinary or commercial use or for a particular purpose appearing from the agreement'. Israeli case law tends to regard a statement by a seller as to the quality of the property as part of the obligations the seller takes upon herself.¹¹³ This is in line with the majority of jurisdictions.

Expectation as to capacity made by B, A remains silent: the analysis does not change if B states that he wishes to buy a machine which would be able to harvest one acre a day, and A keeps silent. There is no general duty to disclose information during contractual negotiations, but this duty may arise in proper circumstances and it is clear that section 12 expanded liability for non-disclosure.¹¹⁴

When B stated his expectation as to the quality of the machine, it was A's duty to clarify that the machine did not have this capacity. His silence is close to concealment¹¹⁵ and constitutes a breach of the duty of good faith. But it is doubtful whether this could constitute a tort.¹¹⁶

B's expectation as to the quality of the machine might also be considered as part of the contractual understanding between the two and as a contractual warranty which was broken.

Loss and remedies: if the statement is precontractual, B can claim damages which will put him in the position before the contract and the

¹¹¹ Misrepresentation as to the quality of the contract subject matter is a typical breach of the duty of good faith in negotiations: CA 86/76 *Amidar v. Aharon*, 32(2) PD 337 (Hebrew); CA 590/88 *Abraham Rubinstein v. Fisher*, 44(1) PD 730 (Hebrew); CA 790/81 *American Microsystems v. Elbit*, 39(2) PD 785 (Hebrew); CA 794/86 *The Central Society v. Fink*, 44(1) PD 226 (Hebrew).

¹¹² 22 LSI 107. ¹¹³ CA 607/83 *Aharon v. Kresenti*, 42(1) PD 397 (Hebrew).

¹¹⁴ For a duty to disclose by virtue of s. 12 in a contract between a builder and a customer, see Further Hearing 7/81 *Pnidar v Castro*, 37(4) PD 673 (Hebrew).

¹¹⁵ Cf. *Restatement Contracts 2d* (St. Paul, 1981) s. 160.

¹¹⁶ Friedmann and Cohen, *Contracts A, B, C*, ss. 12.63-12.66.

negotiations.¹¹⁷ Had B known the actual capacity of the machine, he would have bought another one with the capacity he wished. B claims the opportunity lost due to the negotiations and contract with A. Lost opportunity as a measure of recovery representing reliance losses operates similarly to damages for performance interest.¹¹⁸ A is thus liable for the losses B incurred due to his inability to harvest the whole crop. But A might be liable also for the losses B incurred in buying a new machine if B could have bought the machine for the same price he paid to A (but not otherwise). The same measure would apply in torts.

If the statement is part of the contract, B is entitled to enforcement, namely to the replacement of the harvester (not if it is a misrepresentation). Otherwise, B is entitled to damages for the immediate losses and for the losses of replacing this machine with a new one.

B might rescind the contract either for the defect in its formation¹¹⁹ or for its breach.¹²⁰ Rescission both for defect¹²¹ and for breach¹²² entails a mutual duty of restitution.

From a standard to rules: two categories of bad faith

The duty of good faith in negotiations is a standard, easy to create, difficult to apply. The true meaning of good faith could be ascertained only by reference to cases which turn the standard of good faith into an operative system of rules.¹²³ The rules might eventually create a road-map which could tell the commercial and legal community in advance what is considered bad faith in negotiations. That means that the doctrine of good faith is best understood by its negative implications.¹²⁴

¹¹⁷ *Contracts Law*, s. 12(b).

¹¹⁸ D. Friedmann, 'The Performance Interest in Contract Damages' (1995) 111 LQR 628, 642-3. See also case 1.

¹¹⁹ *Contracts Law*, s. 15. The official English translation is incorrect: s. 15 talks about mistake caused by *misrepresentation* whereas the translation talks about mistake caused by *deceit*. Deceit is narrower than misrepresentation. Deceit is grounded in intention. Misrepresentation could be made negligently or even in good faith.

¹²⁰ *Remedies Law*, ss. 6, 7. ¹²¹ *Contracts Law*, s. 21. ¹²² *Remedies Law*, s. 9.

¹²³ For the principle of good faith as an open norm which must be concretised in order to be applied, see M. Hesselink, 'The Concept of Good Faith' in Hartkamp *et al.*, *Towards a European Civil Code* (3rd edn), pp. 471, 474-5.

¹²⁴ For the doctrine of good faith as an 'excluder' (regarding contract performance), see R. Summers, 'The General Duty of Good Faith: Its Recognition and Conceptualization' (1982) 67 *Cornell Law Review* 810; S. Burton, 'More on Good Faith Performance of a Contract: a Reply to Professor Summers' (1984) 69 *Iowa Law Review* 497.

Good faith is a dynamic notion. Conduct once considered legitimate might become illegitimate and vice versa. Our road-map reflects the law as it is currently understood. In a more or less stable system, if conduct does not fall into one of the forbidden categories, it is likely to pertain – for the time being – to the zone of no liability, to the zone of freedom of action.

The 13 cases in this study present a myriad of situations from which one could induce two main bad faith categories. The first is predicated on misrepresentation; the second on broken promises. Broadly speaking, where liability for bad faith in negotiations is imposed, the unifying elements of the two categories are fault and reliance. But the two categories are different in nature from each other. The first covers cases where A is responsible for the distortion of B's consciousness during negotiations. The second deals with B's frustrations following A's breaking of his promises during negotiations. Though the factual division between the two categories is not clear-cut,¹²⁵ it has a core in which it does operate, and is useful in offering justifications for pre-contractual liability and in clarifying the problems concerning such liability.

The first category is a natural cause for imposing liability in a contractual environment where voluntary choice is to be guaranteed. Liability within this category is justified when it is coupled with fault of the party making the misrepresentation, and reliance by the other party. The second category is problematic: as long as the promise is not contractual, why should liability be imposed? Such liability is incompatible with the principle of freedom from contract and with the rules that constitute contractual liability. Indeed, the major difference between systems with no principle of precontractual liability (English, Irish and Scots law) and those which do have such a principle (civil law systems) is evident in particular with regard to liability for broken promises. English, Irish and Scots systems will not impose liability for mere breaking of a non-contractual promise. But also among civil systems, the question of when breaking a non-contractual promise is coupled with fault, is a core of controversy.

¹²⁵ E.g. a fraudulent promise is a misrepresentation as to the mental element of the promisor (cases 1, 2 and 10). In American law it is called 'promissory fraud': I. Ayers and G. Klass, 'Promissory Fraud without Breach' (2004) *Wisconsin Law Review* 507. On the other hand, a misrepresentation as to the quality of a property might be regarded as a promise about that property (case 13).

The 13 cases will be grouped following the division between the two categories. They reflect the difference between the common law and the civil law, the difference among the civil systems *inter se*, and also the change that Israeli law has undergone from the common law to the civil law since the introduction of the duty of good faith into its system.

Misrepresentation

This category applies to false statements (including fraudulent promises) made during negotiations. Such conduct stands in sharp contrast to the very conception of contract, which stems from a voluntary choice of action made on the basis of genuine data. No wonder that virtually all systems, regardless of whether they have a principle of good faith in negotiations, would not tolerate it.¹²⁶ Hence, no major change has been made in Israeli law regarding incorrect statements made fraudulently or negligently. In the past, tort liability would have been imposed. Nowadays, section 12 might serve as the principal ground of liability.

It follows that starting negotiations with no intent to make a contract (case 1), to renew it (case 2) or to give it to the one entitled to get it, for example to the lowest bidder (case 10), is bad faith conduct. Similarly, agreeing on the contractual terms and misleading the other party by telling him that no written document is needed, is bad faith conduct (case 11), as is telling the other party that the object sold has a capacity that is actually absent (case 13). In a similar vein, making use of trade secrets which were disclosed only for the purpose of negotiations is improper conduct irrespective of whether there is a principle of pre-contractual liability (case 12). It is, however, questionable whether presenting oneself (mistakenly) as an owner of a property and discovering the truth before the conclusion of the contract is bad faith conduct (case 3). Yet Israeli law, which has adopted a wide rule of pre-contractual liability, is likely to impose partial liability in such a case.

The issue of non-disclosure might reveal the differences between the various systems. There is a general duty not to present misstatements, but no general duty to disclose the truth. Tort law will not impose liability for not disclosing information during negotiations (case 11). But the existence of a duty of good faith might trigger a wider liability for non-disclosure, and indeed this is the tendency in Israel (cases 8, 11, 12, 13).

¹²⁶ For a thorough exposition: Cartwright, *Misrepresentation, Mistake and Non-Disclosure*, Pt I.

Broken promises and frustrated expectations

This category, which raises fundamental issues of contract liability, is not problematic if the promises concerned constitute a contract or are included in a contract. This is the case of a promise regarding the administration of negotiations, such as a lock-out agreement (case 6), or a promise relating to the administration of a tender, for example, a promise to give the contract to the lowest bidder (case 10). Contractual liability applies also in the case of a statement made during the negotiations. A statement, for example, as to the quality of the subject matter of the contract is often considered a contractual warranty (case 13).

The question arises as to what are the proper limits of contractual liability, an issue reflected in the legal status of a promise of marriage (case 5). Such a promise constitutes a special category, in between a contract and a non-contractual promise, and it has been regulated by various legislatures, some of which do not attach any binding force to it (English, Irish, Scots reports). In Israel, the trend leading to expansive liability is reflected with regard to this promise as well. Once it was regarded as contemptible or repulsive. Nowadays, it has gained respectability, and is considered valid even when the promisor is solidly married (case 5).

Another question concerning the proper limits of contractual liability relates to the force of a contract to negotiate in good faith (case 6). Jurisdictions missing the principle of good faith would find it impossible to attribute validity to such a contract.

The expansionist approach in Israel is evident not only with regard to liability for bad faith in negotiations, but also with regard to the very existence of contractual liability. In the past, a memorandum subject to contract was not regarded as binding unless a formal contract was concluded (case 4). Nowadays, such a memorandum is usually considered binding. Retraction from it is a breach of contract. Indefinite contracts which the parties intend to complete have been often regarded as binding and are being filled in with the relevant default rules (cases 6 and 7). Hence, contractual liability often overrides pre-contractual liability.

On the verge of contractual liability, in a middle ground between contracts and restitution, are cases concerning benefits received during the negotiation process. Benefits that were transferred during negotiations were generally regarded in the past as absolute transfers entailing no liability. Such transfers were within the risk of negotiations. Only if

they were given on the condition that a final contract is concluded might a cause in restitution have ensued. Though the distinction between absolute and conditional transfers is still valid (case 5, engagement ring), nowadays benefits given on request during negotiations tend to trigger liability (case 4). This might be more forceful when the benefits consist of the very performance of the contract (case 9). Receiving the benefit without protest, keeping it and not paying for it might be regarded as a breach of an implied promise, as bad faith conduct or as a ground for restitutionary liability. This does not differ from previous law.

The most difficult cases are those where negotiations were in an advanced stage not far from conclusion and one party breaks them off. Should the expectations of the other party be protected? Should any force be attached to promises given during failed negotiations? Is retraction bad faith conduct (case 7)? Do advanced negotiations impose a duty not to engage in parallel negotiations (case 4)? Could advanced negotiations substitute for the absence of a formal document (cases 3 and 11)? Is it bad faith conduct to stick to the rules which provide the conditions for the creation of a valid contract (cases 3, 4, 7, 8 and 11)? This is where the schism between the common law and the civil law is most conspicuous and this is where the change in Israeli law is the most radical.

In the past, the demarcation line in Israel between contract and negotiations was quite clear. Negotiations meant freedom: freedom to deal with others (case 4) or to make non-binding promises. Currently under the precontractual regime, liability progresses with the progress in negotiations. That means that even before a contract is made, negotiations can reach the point of no retraction where no justifiable excuse exists¹²⁷ (cases 7 and 8). This might limit the power of parallel

¹²⁷ The mark of the change could be found in CA 579/83 *Sonnenstein v. Gabaso*, 42(2) PD 278 (Hebrew), above note 23, where the parties signed a memorandum for the sale of an apartment and decided to agree further on the issue of instalment payments. The buyer argued that the parties actually reached an agreement on that point, but that the seller had insisted that a smaller sum than the agreed purchase price be written in the contract. The buyer rejected that, and the seller refused to sign the contract. The Supreme Court was divided: the majority held that no contract was concluded without the signatures of the parties. Therefore, each of them could withdraw at any point for any reason. This is the classical approach endorsed by English law. However, the minority judge, Barak, held that if the buyer's version was correct, then the seller by his illegitimate requirement prior to the conclusion of the contract broke his duty to act in good faith. The court might regard the contract as if it were

negotiations at that stage (Case 4). Statements and promises made during negotiations might occasionally constitute grounds of liability, even though a contract has not been eventually concluded (case 3). The expansive interpretation of section 12 is reflected where formal requirements for the conclusion of a contract were not met. In the past, there was hesitance in Israeli law whether to ignore the formal requirements. Nowadays, they are more easily ignored depending on the interplay between the fault of the party insisting on the formal requirements and the reliance by the other party (case 11).

Instead of the once binary system of contract (liability) – no contract (no liability), we have now a trinary system, consisting of three zones: no liability zone; precontractual liability zone; contractual liability zone. The no liability zone has been reduced in comparison with the one that preceded section 12. The precontractual zone has been largely extended and it could practically lead to a zone of contract liability because of the possibility of awarding the remedies of enforcement or performance damages. This interpretation, which deviates from the language of section 12, according to which the sole remedy it offers is reliance damages, deviates also from the approach of the vast majority of civil law jurisdictions, and is similar to that obtaining in the Netherlands.

Was there a price to be paid for the move?

The principle of good faith in section 12 is a flexible standard imposing a regime of liability during negotiations. Under this regime, the values of co-operation and solidarity, regarded as the core of modern contract law, have become part and parcel of the negotiation process. As shown in the various cases, good faith might occasionally clash with formal rules. This conflict reveals the advantages and disadvantages of rules versus standards. Rules are more difficult to create, more easy to apply. Standards are easier to create, more difficult to apply. Rules might be under- or over-inclusive, but easy to predict. Standards frequently serve as a corrective to over- or under-inclusiveness, but their application is

actually concluded. The content of the contract would be comprised of the memorandum and the oral agreement reached by the parties on the issue of the instalment payments. Ten years ago, Justice Barak became the president of the Supreme Court and his expansive approach, which once was in the minority, has since become the dominant one in Israeli law.

difficult to predict. Standards give ample discretion to the court, thus creating a potential for an incoherent, uneven application. Standards enlarge the grey area and may encourage non-compliance with the rules: just as rules create expectations regarding their application, so does deviation. Standards create uncertainty both on the part of the judiciary and on the part of the contracting parties.

The experience of Israeli law demonstrates that a price must be paid for the desire to enhance the standard of moral behaviour in the contractual arena. To the uncertainty as to the question whether a contract has been created at all, another certainty has been now added, namely whether even in the absence of a contract the negotiations involve a breach of the duty of good faith, and if so, what is the proper remedy. It follows that almost any negotiation is susceptible to future litigation, the results of which are hardly predictable.

The Supreme Court case of *Kal-Binian v. A.R.M.*¹²⁸ might serve as a good example. In a bidding case, the District Court ruled that no contract was concluded, and no breach of the duty of good faith occurred. The majority of the Supreme Court reversed the decision and held that, though no contract was concluded, there was a breach of the duty of good faith in negotiations. The minority judge held that a contract was concluded. The District Court to which the case was referred again for ruling on the issue of remedies awarded reliance damages, but on appeal the Supreme Court reversed the decision and ruled that the proper remedy is performance damages. All this litigation took about ten years.

This case (it is not the only one)¹²⁹ attests not only to the instability, to the absence of demarcation lines between contract and negotiations, and to the vagueness regarding bad faith conduct, but also to the embarrassment shared by both litigants and judges resulting from the plethora of causes of action and remedies in this sphere. Apart from the problems of uncertainty and unpredictability in this field, such a case

¹²⁸ CA 6370/00, 56 PD(3) 289 (Hebrew).

¹²⁹ See also CA 2071/99 *Panti v. Izahary*, 55(2) PD 721 (Hebrew), above n. 71: the District Court decided that the memorandum was a binding contract. About three years later, the Supreme Court reversed the decision but held that the seller acted in a manner contrary to the duty of good faith in negotiations. The Supreme Court referred the case back to the District Court to consider the proper remedy which might be reliance damages, restitution or even performance damages.

clearly exemplifies the intensive investment in energy and time both of litigants and of the judiciary. It is to be hoped that, during the years to come, the standard of good faith will gradually turn into a set of workable, definite rules.¹³⁰

¹³⁰ N. Cohen, 'The Effect of the Duty of Good Faith on a Previously Common Law System: the Experience of Israeli Law' in Brownsword, Hird and Howells, *Good Faith in Contract*, pp. 189, 209-12.

4 A law and economics perspective on precontractual liability

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The problem

Negotiations are the natural prelude to a binding agreement. During negotiations, parties evaluate contractual opportunities and define the terms of a mutually profitable transaction with an informal exchange. They speak with each other and communicate their respective interests and expectations regarding the potential transaction. During these interactions, the parties often preserve a certain degree of 'freedom of negotiation'.¹ Before entering into a binding contract, parties retain some freedom to change their mind, to negotiate with other prospective parties, to acquire information to verify the profitability of the proposed transaction, and to hold out if changes in the circumstances or some other aspect of the transaction make it unprofitable. A necessary consequence of the parties' freedom of negotiation is the lack of binding force of their manifestations of intent. Expressions of intent during the negotiation phase do not bind the parties and generally cannot be used to obtain performance before a contract is finalised. Negotiations enable parties to test the feasibility of a mutually beneficial transaction.

During negotiations, as information is gathered and the prospective contract begins to take shape, it may become reasonable for parties to make some reliance investments. From an economic perspective, these reliance investments may indeed be beneficial (for one party or for both) because they can increase the value of the contract, if the parties enter into one.² While potentially increasing the net private surplus

¹ E.A. Farnsworth, 'Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations' (1987) 87 *Columbia Law Review* 217, 221.

² R. Craswell, 'Offer, Acceptance, and Efficient Reliance' (1996) 48 *Stanford Law Review* 481, 495.