



PRE-CONTRACTUAL LIABILITY

New rules for contractual negotiations

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The topic of this Newsletter follows up to our previous Newsletter issue No. 7, which was devoted to the most significant changes in the area of the contract law and execution of contracts under the new Czech civil law as introduced by the New Civil Code (Act No. 89/2012 Coll., the **NCC**). In this Newsletter, we will particularly address one of the newly introduced institutes - so called **pre-contractual liability**.

As this institute is a novelty to the Czech legal system and it is something everybody, who will enter into contractual negotiations, may face, we feel that it is useful to look at pre-contractual liability in more details and allow us to introduce to you its basic principles as well as conditions under which it can be enforced and what may be the consequences of its breach.

As stated above **pre-contractual liability** is addressed by the NCC, namely by its provisions **1728 and 1729**.

Former civil law, i.e. the Act No. 40/1964 Coll., the Civil Code and the Act No. 513/1991 Coll., the Commercial Code, in force till 31st December 2013, did not provide for any compact regulation of this principle. One exception could be found in the Commercial Code where parties were obliged to keep confidentiality with respect to information being disclosed during contractual negotiations. However, this regulation had been specific and applicable only to commercial relations.¹

The overall lack of specific regulation for pre-contractual liability had been over the time bypassed by the rulings of Czech courts based on the general obligation to prevent occurrence of damages (mitigation obligation).² However this approach proved in practice as insufficient, because it did not provide for desired level of legal certainty to the parties.³ For this reason the

¹ Section 271 of the Act No. 513/1991 Coll., the Commercial Code

² Section 415 of the Act No. 40/1964 Coll., the Civil Code; Pelikánová, I. and Pelikán, R.: Section 1728. Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

³ Benez, O.: *Jak je to s p edsmluvní odpov dností v NOZ?* <http://www.epravo.cz/top/clanky/jak-je-to-s-predsmluvni-odpovednosti-v-noz-96207.html?mail>

new Czech civil law provides as part of the recodification process exact rules for contractual negotiations, including the institute of pre-contractual liability.

The new law is based on the mandatory principle **of autonomous will of contracting parties**, which gives to the parties freedom to decide whether they will enter into a contract, what will be the terms and conditions of such a contract and what form of contract they will use. In other words everybody is free to hold contractual negotiations and freely decide whether or not he will enter into the contract or not. At the same time such freedom is not unlimited and is defined by the pre-contractual liability. Under the new law the negotiating parties undertake certain rights and obligations throughout the contracting process, such as obligation to act in good faith, not to misuse it position or right, including right of contracting freedom and autonomy of will.⁴ A breach of an obligation to act in good faith and fairly represents pre-contractual liability (*culpa in contrahendo*).⁵

⁴ Sections 6 and 8 of the Act No.89/2012 Coll., the New Civil Code; Pelikánová, I. and Pelikán, R.: Section 1728. Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

⁵ Callaghan, I.: *P edsmluvní odpov dnost*. <http://www.epravo.cz/top/clanky/predsmluvni-odpovednost-96340.html?mail>; Unklein, P.: *Obchodní tajemství a know-how podnikatele v ohrožení aneb pom Ěe nám p edsmluvní odpov dnost?* <http://www.epravo.cz/top/clanky/obchodni-tajemstvi-a-know-how-podnikatele-v-ohrozeni-aneb-pomuze-nam-predsmluvni-odpovednost-98079.html>

The NCC defines four different merits for pre-contractual liability:

- a) Initiation of, or proceedings with, contractual negotiation without the will to finalize the contract (Section 1728 (1) of the NCC);
- b) Breach of information duty (Section 1728 (2) of the NCC);
- c) Non-conclusion of a contract when its finalization is deemed to be very likely (Section 1729 of the NCC);
- d) Misuse and disclosure of confidential information (Section 1730 of the NCC).

A. Initiation of, or proceedings with, contractual negotiation without the will to finalize the contract

First merit of pre-contractual liability is referred to also as negotiating the contract in bad faith and is specified in **Section 1728 (1) of the NCC**.⁶ It relates to cases when a party initiates contract negotiations from its own initiative (or continues in such negotiations) without its intention to actually conclude the contract.

⁶ Section 1728 (1) of the Act No. 89/2012 Coll., the New Civil Code; Pelikánová, I. and Pelikán, R.: Section 1728 (1). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

This merit is very closely tied with a generally imposed obligation to act in legal relations in good faith.⁷ The key fact establishing liability for non-conclusion of contract is **the acting in bad-faith**, where party which loses its interest in the finalization of the contract during the contractual negotiations, does not immediately inform the counterparty and does not terminate the contract negotiations or even initiates the contractual negotiations without its will to conclude the deal itself. This party is only pretending its interest to conclude the contract, from the beginning of the process or later on.⁸

Such a party incurs legal liability. The counterparty, which is acting in good faith, may therefore demand compensation of damages.

It is good to rephrase that as the principle of autonomous will of contracting parties is prevailing, the fact that a party does not conclude a contract cannot be sanctioned, it is only the above described bad faith legal action that is establishing legal liability for the relevant party.

⁷ Section 6 of the Act No. 89/2012 Coll., the New Civil Code

⁸ Callaghan, I.: *P edsmluvní odpov dnost*. <http://www.epravo.cz/top/clanky/predsmluvni-odpovednost-96340.html?mail>

B. Breach of information duty

Second merit of pre-contractual liability is defined in Section **1728 (2) of the NCC** and it is represented by breach of a statutory information duty.⁹ According to this rule, potential contracting parties have an obligation to inform each other about any and all actual and legal facts, which they know or should have known, so the party may assure its ability to conclude a valid and binding contract and demonstrate its will to finalize the deal.

Information duty applies to all possible types of contracts and all kinds of contracting parties. Certain relation, such as consumer vs. entrepreneurs, may even have stricter information duty.¹⁰

Regarding the actual **extent of information**, which needs to be disclosed during contractual negotiations, the law is silent in providing extensive list. First area of information includes information concerning actual and legal facts on the basis of which the other party will be able to

⁹ Section 1728 (2) of the Act No. 89/2012 Coll., the New Civil Code; Pelikánová, I. and Pelikán, R.: Section 1728 (2). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

¹⁰ Callaghan, I.: *P edsmluvní odpov dnost*. <http://www.epravo.cz/top/clanky/predsmluvni-odpovednost-96340.html?mail>

confirm the party's ability to conclude a valid and binding contract.¹¹ This will surely include obligation to immediately inform the other party about any facts, which may give rise to any doubts about the ability to conclude a valid and binding contract (for example facts concerning the ownership title to the assets which are the subject matter of the contract). The parties should also inform each other about facts, which may contribute to the conclusion of the contract (for example obtaining of necessary permits and certifications, disclosing copies of original title deeds to assets which are the subject matter of the contract). Second area of information comprises of information, which allow the contracting party to verify its will to finalize the deal. It follows from the above that each party must above all know its own will whether its intention is to finalize the contract or not. The intention of the other party does not necessary needs to be known to the party.¹²

The extent of information which the parties will be obliged to disclose during contract negotiations will always depend on the individual contract and circumstances. For examples contracts

¹¹ Unklein, P.: *Obchodní tajemství a know-how podnikatele v ohrožení aneb pom Ěe nám p edsmluvní odpov ěnost?*

<http://www.epravo.cz/top/clanky/obchodni-tajemstvi-a-know-how-podnikatele-v-ohrozeni-aneb-pomuze-nam-predsmluvni-odpovednost-98079.html>

¹² Pelikánová, I. and Pelikán, R.: Section 1728 (2). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

between entrepreneurs will have to also take into consideration common practice in the relevant business area.¹³

Regarding actual **validity of contract**, which will be concluded despite breach of information duty . such contract will always be considered valid. Breach of information duty does not by itself cause invalidity (it is not considered a fraud pursuant to Section 583 *et seq* of the NCC). It establishes the right of the damaged party to claim compensation of damages sustained due to a breach of the information duty on the side of the other party.

Breach of information duty may therefore lead to legal liability despite the fact that Section 1728 (2) does not contain any special regulation for liability for damages. In such case the parties will have to follow general statutory liability provisions.¹⁴

¹³ Unklein, P.: *Obchodní tajemství a know-how podnikatele v ohrožení aneb pom Ěe nám p edsmluvní odpov ědnost?*

<http://www.epravo.cz/top/clanky/obchodni-tajemstvi-a-know-how-podnikatele-v-ohrozeni-aneb-pomuze-nam-predsmluvni-odpovednost-98079.html>

¹⁴ Pelikánová, I. and Pelikán, R.: Section 1728 (2). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

C. Non-conclusion of contract so far in contractual negotiations when its finalization is deemed to be very likely

Third merit of pre-contractual liability is defined in Section **1729 (1) of the NCC** and applies to cases when one party will withdraw from the contract negotiation immediately prior to finalization of contract, despite the fact that the other party had reasonable expectations that the contract will be concluded and this is without any justifiable reasons to withdraw.

This merit to some extent overlaps with the first merit specified in Section 1728 (1) of the NCC.¹⁵ While the first one holds a party liable for initiating or continuing in contractual relations without a will to close the deal, this merit protects the parties from sudden withdrawal from contract negotiations without justifiable reason. The first case applies to any phase of the negotiation process, while the second case can occur only during a negotiation phase when the closing of the deal is highly probable.

Legal liability for withdrawing from contract negotiations will be established only if the party withdraws without any justified reason. In other words parties cannot be held liable for terminat-

¹⁵ Section 1728 (1) and Section 1729 (1) of the Act No. 89/2012 Coll., the New Civil Code; Pelikánová, I. and Pelikán, R.: Section 1729 (1). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

ing the contract negotiations, their liability will be established only if they allow the contracting process to evolve so far that the other party reasonably expects the contract to be concluded, but the counterparty withdraws without any qualified reason to do so.¹⁶

The law does not define **justified reason**. Obviously as justifiable will be any circumstances, which were known to the other party or could have been reasonably expected to be. This uncertainty may cause many interpretation issues. Justifiable reason for legal entity may be for example objection against the completion of the deal from public authorities, its employees or trade unions, etc.¹⁷ Questionable may be issue of more favourable competing offer for the relevant contract.¹⁸

In case one of the contracting parties will commit the above described action, it shall incur legal liability to compensate damages to the other party¹⁹. It will be necessary in each individual case to assess the amount of the damage, taking into consideration the principle of autonomous will

¹⁶ Pelikánová, I. and Pelikán, R.: Section 1729 (1). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

¹⁷ Pelikánová, I. and Pelikán, R.: Section 1729 (1). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

¹⁸ Callaghan, I.: *P edsmluvní odpov dnost*. <http://www.epravo.cz/top/clanky/predsmluvni-odpovednost-96340.html?mail>; Benez, O.: *Jak je to s p edsmluvní odpov dností v NOZ?* <http://www.epravo.cz/top/clanky/jak-je-to-s-predsmluvni-odpovednosti-v-noz-96207.html?mail>

¹⁹ Section 1729 (2) of the Act No. 89/2012 Coll., the New Civil Code

of contracting parties. Section **1729 (2) of the NCC** also caps the liability by the maximum amount of the loss from the lost contract in similar cases.

The term **loss from lost contract** can be also quite problematic and vague. Parties may question whether the loss from the lost contract is the actual profit the party would make if the contract had been concluded. In case of dispute, it would be reviewed if an alternative contract was possible to be concluded and in such case the profits could be compared. If the alternative contract would be less favourable, the loss would be the difference between the reached profit from the alternative contract and the expected profit from the lost contract. If there is no alternative contract signed to the lost contract, the calculation of the actual damage sustained may be a bit more problematic.²⁰ In this case the harmed party needs to investigate what is the profit in similar cases, which may be difficult for certain contract types or for contracts concluded for indefinite period of time.²¹

²⁰ Pelikánová, I. and Pelikán, R.: Section 1729 (2). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

²¹ Benez, O.: *Jak je to s p edsmluvní odpov dností v NOZ?* <http://www.epravo.cz/top/clanky/jak-je-to-s-predsmluvni-odpovednosti-v-noz-96207.html?mail>

D. Misuse and disclosure of confidential information

Last merit of pre-contractual liability is stated in **Section 1729 (1) of the NCC** and establishes legal liability due to misuse and disclosure of confidential information obtained during the contractual negotiations.

The above provision of NCC relates to Section 1730 (1) and 1728 (2) of the NCC. Pursuant to these provisions one party complies with its information duty by providing the other party with relevant information for the contractual negotiations. The other party is entitled to make notes of such information (regardless of the fact whether the contract is concluded or not). In other words party is **entitled to keep records** of contractual negotiations, regardless of the fact whether the contract is closed or not.²²

Section 1730 (2) of the NCC imposes a confidentiality duty upon the recipient party with respect to the information received during contractual negotiations. At the same time the law does not provide for any definition of the term **confidential information** and does not even require the

²² Pelikánová, I. and Pelikán, R.: Section 1730 (1) and (2). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI; Benez, O.: *Jak je to s p edsmluvní odpov dností v NOZ?* <http://www.epravo.cz/top/clanky/jak-je-to-s-predsmluvni-odpovednosti-v-noz-96207.html?mail>

parties to mark relevant information as such.²³ It follows from the said provision that the law provides for statutory protection of information, which is objectively seen as confidential, without the need to be expressly specified as such.²⁴ Nevertheless it goes without saying that it is more than recommended for the disclosing party to mark which information it considers to be confidential and keep this declaration as future evidence for any later dispute.

In case of breach of confidentiality duty, the harmed party may seek compensation amounting to the unjustified enrichment on the side of the breaching party (if applicable). The harmed party may also demand compensation of damages pursuant to general statutory rules, regardless whether the negotiated contract is finalized or not.²⁵

4. Conclusion

In summary the implementation of the pre-contractual liability institute into the NCC can be seen as a positive move, as it will bring a greater level of legal certainty to parties during their con-

²³ Unklein, P.: *Obchodní tajemství a know-how podnikatele v ohrožení aneb pomůžeme nám předšmluvní odpovědnost?*

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²⁴ Beneš, O.: *Jak je to s předšmluvní odpovědností v NOZ?* <http://www.epravo.cz/top/clanky/jak-je-to-s-predsmluvni-odpovednosti-v-noz-96207.html?mail>

²⁵ Pelikánová, I. and Pelikán, R.: Section 1730 (2). Pre-contractual liability. The New Civil Code: Commentary, Volume V, (Sections 1721-2520), ASPI

tractual negotiations. On the other hand the new law will without any doubt bring number of questions and interpretation issues as it uses vague terms such as *justified reason*, *loss from lost contract*, *confidential information*, etc. Difficulties can be also expected in proving the amount of suffered damage, casual relation between the breach of contractual liability and the occurrence of damage. The burden of prove lies with the harmed party.

All of the above can cause certain complications in practice and it will be necessary to wait for rulings of the relevant courts to help with the law interpretation. The contracting parties have freedom to clarify areas which could be problematic right at the start of the negotiations process and if required sign confidentiality agreement. We also recommend keeping evidence of all negotiating correspondence and communication.

We hope the above summary will ease your orientation in the new legislation. We are available for any of your additional requests or information.

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