

# The Good Faith Principle and Its Consequences in Pre-Contractual Period: A Comparative Study on English and French Law

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## Abstract

Accepting the principle of good faith in the pre-contractual period entails certain consequences. Observing this principle would require that the parties cooperate and exchange information by exhibiting utmost honesty, transparency, and seriousness in their preliminary talks towards achieving their mutual goals; and that each party, while respecting the information confidentiality of the other party and refusing to enter into parallel negotiations, shall respect the other party's interests. The principle of good faith is not explicitly recognized as a general rule in Iran's statutes. Although the necessity of observing the principle of good faith in all laws and obligations in all instances including the pre-contractual period can be proved using the principle of induction from the criteria stipulated in Article 8, Iran's Law of Civil Liability (i.e., Law of Torts) as well as other current Iranian regulations, this method would not convince the legal Iranian community to accept the principle of good faith as a general rule. Therefore, social and economic imperatives would necessitate that the principle of good faith should be recognized explicitly in the Iranian statutes.

**Keywords:** Principle of Good Faith, obligation to provide information, confidentiality, (refraining from) parallel negotiations, (exhibiting seriousness and transparency in) preliminary talks

## 1. Introduction

The principle of good faith is recommended in all instances where morality and conscientiousness are involved. Although this principle has played a prominent role in personal and social relations among human beings [1], it has mostly been considered as a symbolic act of morality without being protected by external sanctions [2]. In line with development of human societies and emergence of complicated differences among human entities, the principle of good faith was introduced to the legal arena in order to bring the inflexible legal rules and regulations closer to the principles of justice and equity. Today, the principle of good faith is recognized internationally as a fundamental principle which forms the basis of many other obligations [3]. Although good faith is originally rooted in human morality and conscience, alas it was not these qualities that necessitated the observance of this principle, but the fact that the profit-driven man found through experience that commerce and exchange of wealth in society would prosper if relations were based on mutual good faith.

Today, we can claim that the principle of good faith has acquired a moral-legal identity which makes it a serious component in commercial relations. Thus, the argument that the principle of good faith is being more and more alienated and weakened in modern trade laws [4] is essentially faulty since social relations are based on correctness and honesty, indicating that good faith does indeed govern human societies [5]. Due to the fact that most governing rules during the pre-contractual period are based on the good faith principle, this principle can be regarded as the center of gravity of all pre-contractual interactions.

Upon explaining the meaning of the principle of good faith and the significance thereof in the legal systems of certain countries, the authors shall subsequently study the consequences introduced by this principle in the pre-contractual period.

## 2. The Concept of Good Faith

In spite of the fact that many legal systems recognize the principle of good faith and that some countries have included this principle in a number of their regulations, no specific definition has yet been given for "good faith".

Some argue that good faith is a concept which is seemingly easy, yet difficult to interpret [6], whereas others believe good faith is a subjective, qualitative, and vague concept which is difficult to define [7].

“Good faith” consists of two words, namely, “good” and “faith”, and is always associated with fair treatment. Black’s Dictionary of Law defines “good faith” as “a subjective state based on honesty of belief or purpose; commitment regarding one’s obligations towards another; observance of conventional trade standards; observance of fairness in trade, business, or vocation; and lack of deliberate intent to defraud or deceive another, or obtaining concessions against conscience.” [8]

Foreign (non-Iranian) scholars have resorted to different interpretations for defining good faith. Some have interpreted good faith as “correct and fair observance of contractual obligations in ways deemed as acceptable in the trading tradition” [9]. Others argue that the principle of good faith is a fundamental principle derived from the rule known as “Pacta Sunt Serva” as well as other legal rules related to fairness and honesty [10]. Yet, some others believe that good faith in international trading must be defined by referring to conventional and reasonable standards. From their perspective, “reasonable” means something deemed as acceptable in the trading tradition [11].

French jurists have identified two general and independent definitions for good faith; the first being “honesty in legal actions”, and the second “a negligible misconception which is supported as a right” [12]. Based on these definitions, good faith has two separate applications. In its first application, good faith is used as an enforceable rule in conclusion, execution, and interpretation of contracts, and in its second application, good faith is used as a legal basis to justify supporting a person against the misconception arising from that person’s lack of knowledge or awareness [13].

The second concept, regarded mostly in French Law, would cause the legislator to support an uninformed person. This concept has also been considered by Iranian civil rights scholars. For this reason, they consider a person who “believes” to have taken correct legal action, or material action with legal consequences, as having taken such actions in “good faith” [14].

In line with this, some believe good faith is the state of mind of a person who has taken a wrong legal action, thinking the action to be in accordance with the law. In such a case, the legislator shall protect, to some extent, this person against the adverse consequences of the wrong legal action. In this regard, such concepts as integrity, honesty, and fairness are adhered to. Though these concepts do, to a certain degree, remove the vagueness from the definition of good faith, none is complete in itself. Accordingly, perhaps the following might serve as a better definition: “Good faith is the honest, fair, and reasonable behavior expected from both parties towards each other as well as towards the third parties related to a contract during the preliminary negotiations, conclusion, execution, and interpretation stages of that contract.”

### **3. The Significance of Good Faith in various Legal Systems**

In view of its influence and application, the principle of good faith has been adopted in various capacities in the legal systems of different countries. In some countries, this principle is a pervasive principle affecting all aspects of laws and legal obligations, whereas in other countries, it is implemented merely for interpreting and enforcing contracts. Upon examining the principle of good faith in the French and English legal systems, we shall study the significance of this principle in Iran’s legal system.

#### *3.1 Good Faith in French Law*

Until the late 15<sup>th</sup> century, the principle of good faith played no significant role in French Law. However, with the expansion of commercial relations in the 16<sup>th</sup> century, this principle was adopted and adhered to. Although the concept of good faith can be sporadically observed in French regulations, it has not been included as a general rule in any legal text [16]. Without defining good faith, Clause 3, Article 1134 of the French Civil Code stipulates that parties to a contract are obligated to execute the contract “in good faith”. The general assumption in the French legal system is that all contracts are based on good faith [17]. For this reason, by citing the sporadic regulations wherein this principle has been implied, French courts and jurors recognize the principle of good faith and adhere to the results thereof in different cases.

#### *3.2 Good Faith in English Law*

The principle of good faith has encountered numerous problems in the English legal system due to the emphasis placed in this system on individualism [18]. Acceptance of this principle would entail deeming every action/nonaction as one based on good faith, thus making relational outcomes between parties unpredictable. On the other hand, lack of a clear definition of good faith would lead to issuance of different votes by courts adopting the principle of good faith. The English legal system has not shown any inclination towards accepting

the principle of good faith; however, this does not mean English Law has altogether dispensed with good faith [19]. The rule of equity, the theory of promissory estoppels, and certain other obligations such as those included in insurance contracts, can only be justified through the principle of good faith. On the other hand, good faith is, explicitly or implicitly, included in certain statutes of English Law. For example, the 1986 Trade Representatives Procedure and the Marine Insurance Law repeatedly refer to good faith [20].

English courts have long been aware of and accepted the concept of good faith. For example, in the *Philips vs. Brooks* case in 1919, an impersonator pretending to be a person known to the jeweler by name managed to carry a ring out of the jeweler's shop and pawn it near a third person. The court, while ruling that the contract between the jeweler and the fraudster had to be cancelled, also voted that the third party's action was justifiable since that party had acted in good faith [21]. English courts have, in certain other instances and without adhering to the principle of good faith as a general rule, voted that damages arising from non-observance of this principle be compensated.

### 3.3 Iranian Law

Although some of the governing principles of contracts in the Civil Code have been explicitly reiterated in Iranian Law (e.g., the "doctrine of genuineness" and the "principle of necessity of contract" stipulated in Articles 223 and 219 of Iran Civil Code respectively), there are no direct rules on the principle of good faith or the necessity of observing the same. For this reason, some believe that in the Iranian legal system, a person's good faith or lack thereof is not a determinant in the genuineness and effects of a contract [22].

Nevertheless, absence of a clear statement regarding a person's observance of good faith is not sufficient for completely ruling out the principle of good faith in Iranian Law. An overview of various laws in Iran would reveal that the principle of good faith has been sporadically observed in certain regulations. Perhaps the only remaining problem would be to determine the pervasiveness of this principle as a general rule. If the principle of good faith is recognized in the Iranian legal system, then it can be generalized to the different disciplines of Law of Contracts including the pre-contractual period; and if this principle is adhered to only in exceptional cases, then reference must be made to those articles of law where the principle of good faith has been explicitly recommended for it to be observed. After an overview of certain regulations in Iranian Law where the principle of good faith is accepted, we shall explain the views expressed in this regard by different jurists.

#### 3.3.1 Good Faith in Written Laws

Competition is a most important factor in trade, bringing about increased efficiency and quality, as well as reduced prices for goods and services. However, only legitimate (fair) competition is acceptable in the trading arena. In Clause 2, Article 10bis of 1883 Paris Convention on supporting industrial ownership, unfair competition is defined as any act of competition contrary to honest practices in industrial or commercial matters.

Article 8 of Iran Civil Liability Code (ratified in 1960) has enumerated certain competitions as unfair. According to this article, "A person seeking to damage another person's reputation or position through spreading false statements shall be subject to due compensations. The person who loses its customers or suffers business losses as a result of such statements spread in violation of the principle of good faith shall be entitled to legally demand such operations to cease, and, in case the offender's guilt is proved, shall be entitled to due compensation." This is the first instance of an explicit reference to the principle of good faith in Iranian Law. Citing this principle indicates that the legislator has taken into account the principle of good faith in mutual interactions; moreover, based on legal reasoning, since the above article bears no specific characteristics to limit the application of the principle of good faith, we can generalize this principle to other fields including mutual relations between parties during the pre-contractual period.

##### 3.3.1.1 Good Faith in Insurance Contracts

Good faith plays a prominent role in insurance contracts. That is why an insurance contract is also known as a "good faith contract" [23]. Conclusion of an insurance contract is based on the information submitted to the insurer by the policy holder. This information is presented to the policy holder in a document entitled "insurance offer". Since the insurer relies on the information presented by the policy holder as the basis of the necessary calculations, the policy holder's good faith and honesty in providing such information would be of vital importance to the insurer. For this reason, the insurance offer can be regarded as a criterion for the policy holder's good faith.

According to Article 11 of the Iran Insurance Law, "If the policy holder or the representative thereof present, with the intention of financial fraud, an amount in excess of the fair price at the insurance contract conclusion, then the insurance contract shall be null and void, and the received insurance premium shall not be refundable."

Article 12 of the same law states, “If the policy holder intentionally withholds certain information or intentionally makes untruthful statements, and if such withheld information or untruthful statements serve to introduce any change in the subject of the risk or reduce the significance thereof in the eyes of the insurer, then the insurance contract shall be null and void, even if the mentioned information or statement does not affect the manner in which the accident occurs. Under such circumstances, not only shall the insurance premiums paid by the policy holder be nonrefundable, but also the insurer shall be entitled to demand that the policy holder pay the insurance premium installments in arrears.”

The general rules of contracts stipulate that cancellation of the insurance contract shall render ineffectual any and all successive actions. However, in spite of acquitting the insurer from its obligations, these articles entitle the insurer to the insurance premium; a seemingly illogical entitlement. On the other hand, this can be justified by taking into account that the policy holder would have to be subjected to this civil punishment because of the dishonesty and lack of good faith demonstrated by the same. Such justification is further strengthened in Article 13 of the same law which stipulates that if the untruthful statements or withholding information on the part of the policy holder is not accompanied by lack of good faith, then the insurance contract shall not be cancelled, but the insurer shall be entitled to cancel the insurance contract and refund to the policy holder the received extra premiums paid by the policy holder before the date of cancellation.

#### 3.3.1.2 Good Faith in E-Commerce

Electronic commerce (E-commerce) is defined as trading goods and services by means of telecommunication-based electronic tools and devices. Article 3 of Iran E-Commerce Law (ratified in 2003) stipulates that the principle of good faith shall be necessarily observed in the interpretation of the regulations set forth in this law. According to Article 35 of the same law, “The declared information to the consumer and confirmation thereof shall be durable, clear, and explicit, and presented in due time through proper communication means based on the principle of good faith in conducting transactions, while taking the necessary measures to protect the children’s and incapacitated persons’ rights.” Although it does not explicitly refer to the necessity of observing good faith in the pre-contractual and contractual periods, it seems the principle of good faith can be derived from this article.

#### 3.3.1.3 Good Faith of Holder of Negotiable Instruments

Negotiable instruments (also called “trade papers”) including cheques, promissory notes, and bills represent a short-term maturity credit due to a person, which are negotiable [24]. If payment is not made upon due date of a negotiable instrument, then the holder can, upon fulfilling the relevant legal obligations on their due dates, call upon the persons mentioned as debtors in the instrument to pay their respective dues. Sometimes, however, the debtors refrain from paying by challenging (i.e., calling into question or finding fault with) the fundamental relations for the purpose of releasing themselves from their obligations. To prevent such actions and to strengthen the validity of negotiable instruments as well as protecting the holder thereof, certain rules have been set forth, including the principle of “unenforceability of challenges”. According to this principle, persons in charge of a negotiable instrument shall not allow their personal relations with the previous holder(s) of the instrument to interfere with the rights of the present holder(s) thereof. This principle has been recognized in international conventions on negotiable instruments. Although not explicitly cited in Iran Trade Law, this principle can, according to some jurists, be deducted from Articles 230, 231, 249, and 307 of this law. Moreover, Iranian jurisprudence has approved of recognizing this principle in relations arising from negotiable instruments. A prerequisite for acting on the strength of the above principle is demonstration of good faith by the holder of the negotiable instrument. In fact, this principle acts in support of that holder who exhibits good faith.

#### 3.3.2 Good Faith in Legal Theories

Since good faith is not explicitly observed in Iranian Law as a general rule, different views have been expressed by jurists regarding the position of good faith in the Iranian legal system [27]. Some scholars argue that lack of an explicit recognition of the principle of good faith in Iranian Law would make direct enforcement of this principle difficult [28]. Nevertheless, by adhering to various pretexts including implicit conditions, a magistrate can set forth as the basis of his judgment what is called “behavior based on good faith” [29].

Relying on Article 8 of Iran Civil Liability Law, some authors, while acknowledging the observance of principle of good faith in Iranian Law, believe the terms “knowledge” and “ignorance” cited in Iranian Law are actually equivalents of “ill/bad faith” and “good faith” in modern law respectively [30]; and allude to Article 325 of the Iran Civil Law to support their claim. According to this article, “if the customer referred to by the owner is ignorant of the owner’s extortion, the customer can in turn cite the vendor for compensation of the goods or the price thereof even if such goods have been wasted when in customer’s possession; however, if the owner cites

the vendor in such a case, then the vendor shall not be entitled to cite the customer.”

Some authors have taken an intermediate perspective in this regard. They believe that to the extent that Iranian Law is influenced by jurisprudence, it cannot explicitly recognize the principle of good faith. For example, in Article 204 of Iran Civil Code, adapted from Article 204 of French Civil Code, the term “good faith” was subsequently eliminated [31]. These authors argue that good faith somehow overshadows contractual obligations and that good faith must govern contractual terms if conflicts arise. Therefore, to resolve legal problems, sooner or later, the rule of good faith shall have to be explicitly included in Iranian Law.

The lack of explicit reference to the principle of good faith in Iranian Law must not be interpreted as there being a contradiction between this principle and the Islamic religious requirements. In confirmation of this, some authors have interpreted the “option of loss” and “option of defect” as implicit conditions underlying the requirement of relative balance of goods, and the “soundness of goods” as a way of expressing good faith in concluding contracts [32]. Accordingly, good faith would require that the parties to a contract present only sound goods and that each party’s obtained profits shall not cause any losses to the other party.

Article 8 of the civil liability statutes also emphasizes the necessity of observing good faith in trade competitions. The contents of this article and the other regulations referred to herein can be generalized to other commercial activities. It must also be accepted that observance of good faith is not limited to commercial activities since it has been considered in various ways in several articles of Iran Civil Code. Nevertheless, it should be acknowledged that the necessity of observing good faith in the enforcement of all legal rights and duties as well as all fields including the pre-contractual period cannot be proved in any way except logical induction, and this method shall not convince the Iranian legal community to accept the principle of good faith as a general rule. For this reason, and considering the social needs and economic necessities, Iranian Law must be directed towards explicitly recognizing the principle of good faith.

#### **4. Consequences of Good Faith in Pre-Contractual Period**

The principle of good faith entails important effects and consequences in preliminary negotiations. Observance of this principle during the pre-contractual period would require that, to achieve their mutual goals, both parties to the contract employ utmost sincerity, seriousness, and transparency in their cooperation and provision of information while observing the confidentiality of the information entrusted by the other party and refraining from being involved in parallel negotiations, as well as mutually respecting each other’s interests.

##### *4.1 Commitment/Duty towards Seriousness*

The start of preliminary negotiations logically implies that both parties seriously intend to conclude a contract, and that they seek to establish contractual relations. The governing principle here is that no vendor shall be involved in negotiations without intending to sell, and no buyer shall negotiate about the condition of goods without intending to buy the goods. Pre-contractual seriousness is based on the principle of good faith and entails the mutual intent to advance preliminary negotiations. If it is proved during the preliminary negotiations that either party is not serious in its intention to conclude a contract, then that party shall be liable to the other party in this respect.

In French Law, if a party, without intending to be involved in further transaction, starts or continues preliminary negotiations, thus creating anticipation in the other party towards an imminent contract and causing the other party to tolerate undue expenses in this regard, then that party shall be liable to the other party [33]. In a certain legal case, the defendant had been, while negotiating with the other party for letting its property, secretly seeking to sell the same property. The court ruled that the defendant must compensate the other party in terms of that party’s sustained losses since a person seriously seeking to let a property would not simultaneously be involved in negotiations for selling the same property [34]. In Iranian Law, lack of seriousness during the pre-contractual period can render the relevant party liable. Some authors believe that if one party, without any serious intent towards concluding a contract, involves in negotiations for concluding a contract and causes the other party to undergo expenses in this regard, then that party shall pay compensation to the other party for the incurred losses [35]. Others argue that if a party, in the midst of the preliminary negotiations with the other party, concludes a similar contract with a third party, thus causing the other party to tolerate expenses in this regard, then that party shall be liable to the other party for such conduct [36].

##### *4.2 Commitment/Duty towards Transparency*

The purpose of preliminary negotiations during the pre-contractual period is to reach mutual understanding for contracting the main contract. It is noteworthy that negotiating through vague terms shall never bring about the desired objectives for either party. The good faith principle requires that transparency be observed by both

parties during the pre-contractual period. Both parties shall resort to clear and comprehensible terms to express their meaning during the negotiations. Using incomprehensible or polysemous terms which lead to misunderstanding would not only make the achievement of the final goal more difficult, but also increase differences.

The necessity of transparent unambiguous interaction during preliminary negotiations can be observed in the regulations stipulated by certain countries. In English Law, the emphasis in the Insurance Law on the insurers' employing "plain English" indicates that the parties are to negotiate using comprehensible and clear language [37].

In Iranian statutes, vague negotiations during the pre-contractual period can lead to misunderstanding between the parties, thus virtually preventing them from reaching real agreement. According to these statutes, if it is proved that the parties have failed to reach agreement in terms of the nature of the contract or the subject of the interaction due to lack of transparency in the pre-contractual period, then the concluded contract shall be cancelled and rendered ineffective. In addition, if such disagreement regards the secondary terms in the contract, then it can lead to certain options. Therefore, lack of transparency in preliminary and pre-contractual negotiations can damage the stability or credibility of the future contract. Accordingly, in case a party is misguided due to the vague statements made by the other party during the pre-contractual/preliminary negotiations, then the erring party might be considered guilty and responsible for paying compensation.

#### *4.3 Commitment/Duty towards Providing Information*

The philosophy behind preliminary negotiations is exchange of information between the parties so that each party can make the necessary evaluations regarding the conclusion or non-conclusion of the interaction based on the received information. Indeed, the purpose of the good faith principle is exchange of information during the pre-contractual period. During the preliminary talks, the parties must exchange relevant information regarding the fundamental elements of the contract which can influence their decisions, and acquire the required knowledge regarding the terms of interaction as well as the characteristics of the subject of the contract.

The trending in today's legislation is to obligate both parties to observe the principle of good faith by expressing all the factors that could influence the future agreement between them. In the legislation of many countries recognizing the principle of good faith, commitment towards presenting information based on this principle as well as mutual awareness towards contract conditions and disclosing the relevant information based on this principle (i.e., the information which might be impossible for the parties to obtain under ordinary circumstances) has been emphasized.

Due notifications during the pre-contractual period would increase security and stability of a contract [38]. In fact, if a party realizes upon concluding a contract that it has not received the information that could affect its decision regarding the conclusion of the contract, then the contract stability might be at risk. For this reason, it would be better for the parties to improve the stability of their contract by committing to supply the required information in the pre-contractual period.

##### *4.3.1 Scope of Pre-Contractual Notifications*

During the pre-contractual period, the parties cannot be obligated to make all their information available to each other. Indeed, due to the significance of certain information and the effect thereof on the parties' decision making with regard to conclusion/non-conclusion of the contract, it is not always necessary to disclose all information since by accepting the non-conflict of interest principle, the parties cannot be expected to disclose information related to commercial opportunities, information requiring time and effort to provide, and income-generating information without receiving something in return. For example, a car manufacturing company cannot be expected to freely disclose information regarding its newly discovered solution to reducing fuel consumption, or a pharmacist cannot be expected to divulge free of charge the new formula it has found for treating a previously incurable disease. Therefore, the scope of the information made available by the parties during the pre-contractual period must be specified so that the parties will know what information can be disclosed in the preliminary negotiations.

Contract-related information can be generally classified into two groups. The first group entails information which does not significantly affect conclusion of the contract and need not be disclosed. The second group consists of information that influences the parties' decisions regarding conclusion of the contract, which can be termed "important information". Recognizing the principle of good faith during the pre-contractual period by the parties implies that they shall disclose their respective important information to prepare the ground for composing their contractual terms based on full knowledge and healthy determination. Subject of the contract,

personality of the parties in cases where it is considered to be the main reason for concluding the contract, and lack of (the imminent) contract enforcement or effectiveness thereof can be regarded as important information.

#### 4.3.2 Providing Information in Different Legal Systems

Written Law and Common Law systems do not have identical views on recognizing the commitment to provide information during the preliminary and pre-contractual negotiations.

In English Law, there is no general principle recognizing the commitment to provide information during the pre-contractual period. Whereas personal freedom and the maintenance thereof are emphasized in England, it is believed that, during the preliminary talks, each party must endeavor to obtain the required information from the other party without expecting the other party to provide such information voluntarily since, although lack of information during the pre-contractual period can entail adverse consequences, once the commitment to provide information has been recognized, it would be extremely difficult to determine the limits of such commitment [39].

English courts have always maintained that, during the preliminary negotiations, each party may keep its secret information confidential and refuse to disclose the same. In the English legal system, there is no commitment on behalf of the parties to disclose information during the pre-contractual period; however, in certain cases mentioned in English Law or English court rulings, non-provision of information is interpreted as the equivalent of making a false statement. For example, Article 18 of the 1906 English Marine Insurance Law stipulates that the insurance holder is obligated to, prior to concluding an insurance contract; inform the insurer of any and all circumstances within the policy holder's knowledge, which can influence the insurance amount and the insurer's scope of liabilities. In addition, if, in accordance with customs, non-provision of information in certain transactions creates liability for the relevant party, English courts shall take into account such customs in their rulings [40].

French Law places no explicit emphasis on providing information during the pre-contractual period. For this reason, French jurists argued for many years that, due to lack of explicit reference in French Law to the parties' commitment to provide information, it would not be necessary to disclose any information during the pre-contractual period since, in a free society, everyone should obtain its own required information. Gradually, due to the contractual unbalance caused as a result of discrepancies in the provided information by the parties, the theory on mutual commitment of the parties to provide information was set forth, and courts sought, on the strength of the vices of consent theory as well as topics such as deception, mistake/error, or civil liability rules, to find a legal basis for obligating parties to provide information. As a result, today disclosing information is a presumed duty of the parties during the pre-contractual period [41].

Some courts in France argue that non-provision of information affects the legal status of the contract. On the strength of Article 1382 of the French civil code and other general civil liability rules, these courts would, if a contract is concluded without disclosing the relevant information by the parties, not only rule towards compensation of any damages arising from such a contract, but also maintain that a contract concluded without information disclosure can be cancelled. Some judicial votes indicate that if, in spite of the obligation to provide information, a party remains silent during the pre-contractual period, then this might be interpreted as a case of negative fraud. In a certain legal case, the buyer purchased a car based on the figure indicated by the odometer, thinking that the car had a low mileage. What the buyer did not know was that the seller has replaced the car odometer. As a result, the Supreme Court ruled that the seller's refusing to provide information in this case was an example of negative fraud [42].

In Iranian Law, the commitment on the part of parties to provide information during the pre-contractual period has not been set forth as a general rule. According to this law, each party shall provide the other party with information that best serves its own interests. If a party suffers as a result of a mistake made due to non-provision of information by the other party, and if such a mistake is related to the main quality and specifications of the object of transaction, then the contract may be cancelled or terminated. In addition, if the object of transaction is defective and the vendor refuses to inform the buyer of the circumstances, then the buyer can take action to terminate the contract on the strength of the deception/misrepresentation demonstrated by the vendor as the case may be. This may be basically interpreted as legal provision against violation of the implicit agreement between the parties to provide mutual information.

Although Iranian Law does not recognize as a general principle the commitment of the parties to provide mutual information, there are indications of such a commitment in certain cases. Iran Consumer Rights Protection Law (ratified on Oct. 7, 2015) is one such law where the commitment to disclose the relevant information has been observed. According to Clause 2, Article 3 of this law, suppliers of goods and services are obliged to inform the

customers of the following: type and quality, quantity, notifications prior to use, and production and expiration dates of the products. In addition, Article 7 of the same law stipulates that false advertising and misrepresentation, whether through mass communication, mass media, or promotional flyers, which could lead to deceiving or misguiding the consumer are prohibited.

Insurance contracts are also concluded based on the information the policy holder makes available to the insurer. Article 12 of Iran Insurance Law (ratified in 1937) stipulates that if the policy holder intentionally withholds information or makes false statements in a way that such withheld information or false statements changes the nature of the risk or reduces the significance thereof in the eyes of the insurer, then the insurance contract shall be null and void, even if such information does not affect the occurrence of accidents. Providing information in insurance contracts is so important that the policy holder shall be held responsible even if the policy holder bears no ill faith by not disclosing the information. By virtue of Article 13 of the same law, in the absence of ill faith on the part of the policy holder, the insurance contract shall not be cancelled automatically, but the insurer shall be entitled to terminate the insurance contract.

#### 4.3.3 Sanctions predicted for Providing Information

As in any other civil liability case, if non-disclosing information during the pre-contractual period does not cause losses, then no liability shall be created. For this reason, the court must first establish the actual occurrence of losses, and this would require examination of the merits or substance of the case. At the same time, sometimes the mere deprivation of the uninformed person of the necessary information is considered as a compensable intellectual loss. For example, some argue that the mere deprivation of a patient from information regarding the results, consequences, and risks of a surgical operation must be considered as a loss [43].

In cases where the parties neglectfully refuse to provide information in spite of being aware of their respective duties in this regard, three types of sanctions can be observed. The first sanction is to cancel the contract. For example, if a party makes a mistake regarding the subject of the transaction or is ignorant of the contract being forestalled as a result of the other party's not providing the required information, then that party can demand that the court votes to terminate the contract. The second sanction is to grant the right to terminate the contract. Thus, if a party refuses to inform the other party of certain hidden defects/faults regarding the subject of the contract which that party is aware of, then the contract may be cancelled on the strength of option of defect upon the other party's becoming aware of the defects/faults. The same argument can be upheld to terminate the contract based on a party's being unaware of the true price of the object of transaction/contract if certain conditions are met. The third sanction is to pay compensation to the party who has sustained losses as a result of the other party's non-provision of information. This sanction can be the subject of an independent vote or be added to the other two sanctions. In fact, the party who concludes a contract without being provided the required information by the other party can demand, as the case may be, for the contract to be terminated, thus being released of the requirements of the contract. However, in some cases, termination of the contract alone is not sufficient to recompense the party who has sustained losses since that party might have, as a result of trusting the other party, tolerated expenses or lost the opportunity to conclude a new contract with another person. Under such circumstances, the party who has caused damages via withholding information shall be obligated to compensate the other party.

In English Law, two cases are recognized under exceptional circumstances where commitment to providing information has been identified. The first case arises when non-provision of information or false statements on the part of a party proves to impose misinterpretation, negligence, and deceit on the other party. Under such an assumption, if a contract is concluded between the parties, the claimant shall be entitled to demand compensation for the incurred losses in addition to terminating the contract. The second case arises where lack of information provision does not impose such an effect. Under such conditions, the claimant shall be entitled to only terminate the contract [44].

In French Law, non-provision of information during the pre-contractual period also could damage the contract due to such causes as mistakes/errors, deception, or hidden defects/faults regarding the object of the transaction. According to Article 108 of French Civil Code, non-provision of information can lead to mistakes being made on the part of the deprived party and thus, can prepare the ground for contract cancellation. According to Article 1116 of the same code, deception is cited as a cause to cancel a contract. In addition, Article 1641 of French Civil Code stipulates that the vendor shall be liable to the buyer in terms of those hidden defects/faults which would reduce the intended functionality of the purchased property or diminish the application thereof so much that the buyer either would not have purchased the property had the buyer been initially aware of such defects/faults, or would have made such purchase only at a reduced cost.

#### *4.4 Commitment/Duty towards Confidentiality*

According to the principle of good faith, the confidential professional information provided by either party shall not be disclosed by the other party for personal or other purposes. In legal terms, this commitment towards non-divulgence is called “confidentiality”. Today, confidentiality during preliminary negotiations is regarded as a governing principle of pre-contractual relationships between the parties.

In French Law, disclosing confidential information or using such information for personal purposes is considered a violation and causes pre-contractual liability. French Civil Code rules are so flexible that this confidentiality of information during the pre-contractual period can be inferred from them. The Commercial Branch of the French Supreme Court stated on October 3, 1978 that the person entering negotiations with others for the purpose of obtaining information alone shall be held responsible [45].

Two possibilities exist for recompensing the party whose information has been disclosed in cases where the other party, in spite of the acknowledging the mutual commitment of the parties towards non-disclosure of pre-contractual information, acts to disclose or use such information. The first possibility is that the damaged party deserves to receive compensation equivalent to the sustained loss resulting from disclosing or using the confidential information. The second possibility for the damaged party is to receive the equivalent profit obtained by the party as a result of disclosing or using the confidential information, whether the disclosing party has suffered losses or not.

#### *4.5 Refraining from Parallel Negotiations*

Competition in the free market would require that, to select their best options, the parties to a contract can enter preliminary negotiations with several different parties with the purpose of concluding a contract. Under such circumstances, each party may continue the preliminary negotiations based on the supposition that it is the only party involved in such negotiations unless it is specifically mentioned at the outset of the pre-contractual period that simultaneous negotiations involving other parties are under way. Thus, the negotiator shall achieve its goal by concluding a contract with any of the parties without continuing negotiations or concluding contracts with the other parties involved.

There is no consensus among scholars regarding the personal liability of the person involved in simultaneous/parallel preliminary negotiations with several parties. Some believe parallel negotiations during preliminary talks violate the principle of good faith and create liability for the person involved in such negotiations. Others argue that simultaneous negotiations with different parties shall not create liability for the negotiator unless the negotiator is required to conduct exclusive talks. The obligation to conduct exclusive talks may be expressed explicitly or implicitly.

It is noteworthy that as long as parallel negotiations are pursued in earnest and the party involved in such negotiations strives towards selecting the best option, no liability shall be attached to conducting such negotiations. However, once the involved party has selected the desired party for concluding a contract, then continuing negotiations with the other parties shall entail liabilities since such continuations would violate the principle of good faith and can be regarded as an offense.

#### *4.6 Commitment/Duty towards Cooperation and Participation*

The relationship between the parties aimed at obtaining mutual benefits or sharing costs and liabilities is termed “cooperation”. The principle of good faith requires that the parties cooperate during the pre-contractual period. IF the parties refuse to cooperate, they can be charged with pre-contractual liabilities. In fact, to demonstrate their good faith and conclude a reliable contract, the parties shall have to cooperate fully and take all any and all necessary actions in this regard [46]. Failure to demonstrate such cooperation shall be in violation of the principle of good faith. For example, where concluding a contract requires obtaining permission from competent authorities with lack of such authorization rendering any future contract invalid, then the party responsible for obtaining permissions shall provide the necessary authorization. Thus, should the future contract be deemed as invalid or cancelled due to the failure on the part of the relevant party to obtain such authorization, the relevant party shall be held responsible. In addition, if either party refuses to complete the forms required to finalize the contract, then that party shall be obligated to pay compensation to the other party [47].

In French Law, the parties’ obligation to cooperate and participation during the pre-contractual period has been approved by courts. In its vote issued on March 7, 1972, the Supreme Court in France stipulated that in order for the preliminary negotiations to proceed, the parties are expected to cooperate towards reaching final agreement while refraining from allowing trivial obstacles to stop such negotiations. For this reason, the defendant company is cited as responsible for the provision of the necessary administrative conditions for concluding the contract.

#### 4.7 *Duty of Care*

Preliminary negotiations consistently create a kind of credit-oriented legal relationship between the parties by virtue of which each party may expect the other party to respect its interests. In fact, each party shall be obligated to provide the necessary financial, physical, and psychological support for the other party. Such obligations are collectively referred to as “duty of care” and are based on the principle of good faith. The duty of care requires that the parties take care not to harm each other’s interests during the preliminary negotiations.

In English Law, the duty of care is not recognized, and the commercial affairs between the parties during preliminary talks are based on the parties’ individual judgments since each party often thinks of its own interests during such talks and regards as immaterial the interests of the other party. Nevertheless, this principle is not always practiced and there are exceptional cases where the duty of care is recognized.

Note that the English Law is not universally against observing the duty of care during the pre-contractual period. Indeed, in certain exceptional procedures, this duty of care has been accepted without proving the existence of a special relationship between the parties. For example, in the *Demny vs. Jemsen* case in 1997, the claimant began preparing the grounds based on the reasonable assumption that the preliminary talks shall ultimately produce results, leading to contract finalization, whereas the defendant was aware of the harmful effects caused by the claimant’s actions. The court held the defendant responsible for not informing the claimant and not observing the duty of care [48].

In French Law, the “*obligation de vigilance*” (duty to care) is considered as an obligation towards honesty and good faith. This is an obligation by agency by virtue of which the parties are required to take the necessary measures for holding preliminary negotiations and enforcing the contract. Any failure in this regard on behalf of the parties shall entail liabilities for the same. Note that, in French Law, a party’s actions to maintain its own interests are not necessarily regarded as intent to damage the other party’s interests and, as such, shall not be considered a breach of the duty to care principle; the reason is that competition is an established principle in trade and if a trader, in spite of demonstrating legitimate behavior during the pre-contractual period and in line with pursuing its own interests, causes damage to the other party, then that trader shall not be liable for compensation. At the same time, some are of the opinion that, during the pre-contractual period, each party must, rather than thinking exclusively of its own interests, also take into account the interests of the other party. Therefore, if either party evaluates the future contract solely based on its own interests, then that party shall be obligated to terminate the negotiations. In line with this, the Commercial Branch of the French Supreme Court emphasized in its ruling issued on February 22, 1994 that each party had had a duty to protect the other party’s interests, and consequently held responsible the company who had, despite being aware of the other party’s financial incapacity, continued negotiations for implementing a project for the sole purpose of gaining profit [49].

Establishing non-observance of duty to care during preliminary negotiations requires that the claimant prove the defendant is guilty of having committed an offense in this regard. The claimant must also prove that the defendant has failed to demonstrate customary behavior in spite of having been urged to do so. The predictability of the losses to the claimant shall also be proved by the same since, in the absence of predictable losses, the defendant cannot be held responsible for not observing the duty to care principle and consequently, shall not be responsible for compensation.

#### 5. Conclusion

- a) Recognizing the principle of good faith entails effects and consequences in the preliminary negotiations. Observance of this principle during the pre-contractual period requires that, to achieve their common goals, both parties cooperate honestly, seriously, and transparently in terms of providing the required information with due regard of confidentiality of such information, and refrain from conducting parallel negotiations, thus mutually respecting their respective interests.
- b) Non-observance of seriousness during the pre-contractual period can be regarded an offense. If it is proved that a party entered preliminary negotiations without any serious intention to conclude a contract, thus imposing expenses on the other party for providing the means to enforce the contract, then that party shall compensate the other party against such expenses.
- c) In English and French laws, non-provision of information during the pre-contractual period by resorting to false statements, deception, or hypocrisy shall damage the contract, thus entitling the damaged party to cancel the contract as well as demand compensation. In Iranian Law, the obligation to provide information is not recognized as a general rule and no sanctions are set forth for enforcement of the same. In fact, the entitlement of

a party to cancel or terminate the contract due to non-provision of information is justified on the strength of the conditions required for validity of the contract. Iranian Civil Code offers no explicit ruling with regard to associating cancellation of the contract with demanding compensation. Apparently, however, the damaged party may, while requesting the cancellation of the contract, also demand compensation.

d) The principle of good faith stipulates that the confidential professional information shared by either party shall not be disclosed by the recipient party or be used by that party for serving personal purposes. If a party discloses such confidential information in violation of its obligation to observe confidentiality of pre-contractual information, then there shall be two possibilities for compensation in this regard. The first possibility is that the damaged party shall deserve compensation for sustaining losses due to its confidential information being disclosed or used for personal gain. The second possibility is that the damaged party shall receive the profit obtained by the recipient of information as a result of such disclosure of information or personal use thereof, whether the disclosing party has or has not tolerated losses in this regard.

e) Conducting parallel negotiations during preliminary talks is against the principle of good faith and shall create liabilities for the relevant party. As long as parallel negotiations are pursued seriously and the negotiating party holds such talks to select the best option available to the same, no liability shall be directed towards the negotiating party. However, if, in spite of having already selected its future party to the contract, the negotiating party continues negotiating with the other parties without intending to enter into new contracts with them, then the negotiating party shall be responsible towards these other parties.

f) The principle of good faith requires that the parties cooperate during the pre-contractual period. Lack of such cooperation can lead to pre-contractual liabilities for the relevant party. Ultimate cooperation must be demonstrated by those parties who observe the principle of good faith for concluding a credible contract, and they should take any measures necessary in this regard. Any shortfalls in the course of such cooperation shall be regarded as unfair interaction and against the principle of good faith.

g) Preliminary negotiations consistently create a legal relationship between the parties based on mutual trust, by virtue of which each party would expect the other party to respect the interests thereof. This obligation is termed “duty to care” obligation and is based on the principle of good faith, requiring each party not to damage the other party in the course of the preliminary negotiations.

h) Though not explicitly recognized as a general rule in Iranian Law, the principle of good faith must not be interpreted as being against jurisprudence. Article 8 of Iran Civil Code emphasizes the importance of observing good faith in trading competitions. This article and other similar regulations in Iranian Law can be adhered to and generalized to encompass other activities. In addition, we must accept that good faith cannot be limited to commercial activities, and that there are several articles in Iranian Civil Code where the principle of good faith is observed. We must recognize that the necessity of observing good faith in fulfilling rights and obligations in all regards cannot be proved except through the induction method. But the induction method cannot convince the Iranian legal community to recognize the principle of good faith as a general rule. For this reason and with due regard of social and economic requirements, it is necessary that the principle of good faith be explicitly recognized in Iranian Law.

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