Bona fides in negotiating: how disingenuous can one be?

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Swiss law provides for a special basis of liability for conduct contrary to the rules of good faith in the context of pre-contractual negotiations. The more unreasonable the position adopted by a negotiating party, the more difficult it is for that party to successfully claim that the other party who broke off the negotiation is liable.

Judgment of the Federal Supreme Court of 19 March 2020

Case Reference : 4A_313/2019

Facts

The case concerned a hairdresser, tenant of a commercial lease, who had decided to hand over his business. Various merchants were interested, among them a chocolatier who wanted to open a new shop.

The hairdresser and the chocolatier had started negotiating the handover of the business. During the negotiations, the chocolatier had agreed to offer the hairdresser the sum of CHF 50,000, subject to the landlord's acceptance of the change of tenant.

The hairdresser had two choices: 1) to transfer the commercial lease directly to the chocolatier, by remaining jointly and severally liable for the rent for two years (Art. 263 of the Swiss Code of Obligations [SCO]); or 2) to terminate his lease contract and have the chocolatier conclude a new lease contract with the landlord. Given that the hairdresser was not satisfied with the first option, the parties decided they would meet with the landlord to sign, in writing, both the business sale (between the hairdresser and the chocolatier) and the new commercial lease (between the chocolatier and the landlord). Shortly thereafter, however, the hairdresser asked the chocolatier to sign the business sale agreement the day before the tripartite meeting was scheduled to take place.

Without any news from the chocolatier – who suddenly disappeared – the hairdresser opted to break off negotiations with him. Later on, he discovered that the chocolatier had come to an agreement directly with the landlord to conclude a lease agreement and rent the premises previously held by the hairdresser, thereby avoiding to pay the sum of CHF 50,000.

The hairdresser put the chocolatier on notice to pay the price of the business sale discussed among them, i.e. the expected CHF 50,000.

Issue

The Federal Supreme Court had to clarify the scope of the duty to negotiate in good faith: was the chocolatier entitled, after negotiating the business handover agreement with the hairdresser, to enter into a lease agreement directly with the landlord and to get the premises without paying the agreed fee to the hairdresser?

Decision

1. The Federal Supreme Court explained the legal framework for contractual negotiations. The main principle is contractual freedom: everyone is free to enter into, or interrupt a negotiation whenever they want, even without justification.

However, the possibility to interrupt negotiations is subject to good faith (cf. Art. 2 para. 1 of the Swiss Civil Code [SCC]), generally known, in this context, as the *culpa in contrahendo*.

The *culpa in contrahendo* is a basis for liability for persons negotiating a contract. It is based on the idea that talks by their very nature create a form of legal relationship between the negotiating parties and impose on them reciprocal duties, in particular the obligation of negotiating seriously and in accordance with their true intentions. The purpose is to make a party liable for having, through behavior which does not align with its true intentions, given rise to the illusory hope that a deal would be concluded and thus leading the other party to make arrangements or incur expenses in view of this deal. It is contrary to the rules of good faith to agree in principle to the conclusion of a formal contract and to refuse *in extremis*, without reason, to translate it into the required form.

In practice, *culpa in contrahendo* for breach of contract is only accepted in exceptional situations, especially when the type of contact is subject by law to a written form. Neither long negotiations nor the knowledge that the other party has made investments are sufficient. Indeed, incurring costs before the conclusion of the contract has, in principle, to be carried out at one's own risk. The conduct contrary to the rules of good faith does not consist so much in having broken off the negotiations as in having kept the other party in the belief that the contract would certainly be concluded or in not having dispelled this belief in time. In practical terms, failed negotiations will not, in principle, give rise to liability, unless specific elements such as an oral or written commitment give rise to a legitimate expectation that the contract will certainly be concluded.

2. In this case, the Federal Supreme Court clarified that legitimate expectations (that the contract would be concluded) were excluded from the outset – and therefore the pre-contractual liability of the other party would not come into play – when the allegedly injured party knew or should have known that the negotiations would not be successful.

3. In the case at hand, the Federal Supreme Court found that there was no evidence of any agreement that would have been entered into between the chocolatier and the landlord before the hairdresser broke off the negotiations with the chocolatier. Besides, it is rather the attitude of the hairdresser that was at the origin of the misunderstanding that affected the last phase of the negotiations: after having fixed a meeting to sign the business sale and the lease agreement simultaneously, the hairdresser demanded that prior to that meeting the chocolatier sign the business sale contract. This conflicting behavior created an unclear situation for the chocolatier, who was legitimately reluctant to enter into the business transfer agreement without the guarantee of obtaining the commercial lease. The chocolatier's silence obviously did not help the parties find a solution, but he simply refused to sign the business sale since the initial plan was to sign the new lease agreement at the same time.

4. The pre-contractual liability of the chocolatier could not be triggered.

Key takeaway

When the tenant of a commercial lease wants to sell his business, there is a risk that the would-be transferee will come to an agreement directly with the landlord of the premises without the transferor being involved. In order to avoid direct negotiations between the would-be transferee and the landlord, it is in the business interest of the seller to obtain the landlord's consent in advance or, alternatively, to proceed with a transfer of the lease in accordance with Art. 263 SCO, even if it means remaining jointly and severally liable for two years. Last option: draft a letter of intention preventing the buyer from negotiating directly with the landlord.

Comments

Unlike other laws (specifically French law), Swiss law does not, strictly speaking, recognize the concept of "fonds de commerce" (sale of a business) nor does it provide for a specific legal framework. Under these conditions, the transfer of a business must be carried out according to several legal rules, specific to each of the components of the business (lease, furniture, clientele, etc.). In the same way, Swiss law does not recognize the French concept of "droit au bail" (right to the lease), which authorizes a business owner to transfer his lease to another business owner without the landlord being able to oppose it.

Art. 263 SCO does limit the landlord's right to oppose the transfer of the lease under justified reasons; but, in exchange, the first tenant remains liable, jointly with the new tenant, for a period of up to two years. When the tenant has not obtained the prior agreement of the landlord to transfer his lease to any other merchant, he is in an unfavorable position if he wants to sell his business. Indeed, the lease contract is an essential element of the transfer of a business and it is unlikely (as the case commented here shows) that anyone will buy a business without the relevant lease agreement for the premises where the business will be carried out. Case law shows that the absence of a specific legal regime for the transfer of business gives significant power to commercial lessors to the detriment of lessees (cf. recently 4A_30/2020).

In this case, the hairdresser, being in an unfavorable position, acted improperly. He sought to transfer his business at all costs without considering that the chocolatier would not be satisfied with a transfer of the business without assurance that he will take over the lease. Although the attitude of the chocolatier may seem to lack transparency and be unfair since he stopped the negotiation with the hairdresser and began negotiations directly and separately with the landlord, the Federal Supreme Court did not sanction this behavior.

Good faith is the underlying principle of the liability for *culpa in contrahendo*. Since such liability is based on the

protection of the legitimate expectations that one negotiating party holds over the other, it is subject to a fairly subjective assessment by the courts, who put themselves in the shoes of both negotiating parties and rule according to the behavior they find most appropriate.

In short, since pre-contractual liability is only rarely admitted, there is a requirement for the party claiming fault on his counterparty to show irreproachable conduct. If his behavior was not impeccable, it would have been difficult for him to accuse the other party of violating the rules of good faith by refusing to enter into the contract. However, in this case, the hairdresser changed his strategy and pushed for an unrealistic agreement since it cannot usually be expected that the other party would accept this in good faith.

Other sources presenting the case

Blaise Carron, *in Droit du bail*, 2020 p. 15.