THE IMPLICATIONS OF *AV. PETER FENECH NOE VS DIPARTIMENT TAL-KUNTRATTI* ON THE DOCTRINE OF *CULPA IN CONTRAHENDO* UNDER MALTESE LAW

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1. Introduction

The doctrine of *culpa in contrahendo* was first propounded by Jhering who advanced the notion that damages should be recoverable from the party whose blameworthy conduct during contractual negotiations brought about the contract's invalidity or prevented its perfection.[585] The term, which in Latin means '*fault in conclusion of a contract'*, recognises a clear duty on prospective contracting parties to negotiate with care, and in general to refrain from doing anything which may lead the other negotiating party to act against his own interests before the conclusion of the contract.

The theory further provides that liability for the loss suffered by a party to a prospective contract is to be considered as a form of pre-contractual liability. *Culpa in contrahendo* has nowadays spread to almost all the Continental legal systems, yet this remains unrecognised in Common law jurisdictions. The reason underpinning this may be attributed to the different theories adopted by each system; whereas the former follows *la teoria dell'affidamento*.[586] The latter is strictly concerned with the theory of the autonomy of the will.[587]

Maltese Law is traditionally classified as a mixed jurisdictional system of Civil Law and Common Law. A more appropriate classification has been propounded by Kevin Aquilina who contemplates a 'Common Law system with a Civil Law underlying layer.'[588] Consequently, the predominance of the will theory, a core feature of the

[585] Rudolf von Ihering, *Culpa in contrahendo oder Schadenersatz bei nichtigen order nicht zur Perfection gelangten Vertriigen, 4 Jahrbucher fur die Dogmatik des heutigen romischen und deutschen Privatrechts 1 (1861), reprinted in 1 von Ihering, Gesammelte Aufsiitze 327 (1881),* cited in Friedrich Kessler and Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study* [1964] 77(3) Harvard Law Review 401-403.

[586] According to this theory the declaration of the will prevails and bestows upon the person to whom it is addressed a legitimate expectation. He who makes a declaration is responsible for honouring that which he has declared.

[587] Also known as *la teoria della volonta* or *Willenstheorie*, the starting point of which is the freedom of the individual and that a fair balance of the contracting parties' interests is struck upon conclusion of a contract.

[588] Rethinking Maltese Legal Hybridity: A Chimeric Illusion or a Healthy Grafted European Law Mixture? Kevin Aquilina [2011] Journal of Civil Law Studies Vol 4 Art 5

Maltese Civil Code, brought with it an increase in the possibility of abuse in the sphere of contractual negotiations.[589] This to the detriment of the party who had relied on the good faith of the other negotiating party in relation to the conclusion of a contract; but who at the end of strenuous negotiations found himself with no remedy.[590] As a result, the Maltese courts have started to give greater importance to the *affidamento* theory and accordingly to the notion of good faith.

While the Maltese Courts have slowly veered towards the Continental school of thought on this issue, we have still not seen any legislative changes being made to provide for the protection offered in the Italian and German legal systems, which have regulated pre-contractual liability through the promulgation of provisions in their respective Civil Codes. The Maltese system is seemingly more akin to the French position, with the difference that the latter has made up for the lacuna in its law through jurisprudence which has upheld that pre-contractual liability clearly exists. On the contrary, Maltese jurisprudence has provided persisting conflicting views on the matter, clearly illustrating that the move towards a more good-faith centred Civil law approach has been less readily accepted and that the existence of pre-contractual liability under Maltese law is rather thorny.[591]

The divergent views expounded by our Courts range from expressly ruling out the possibility of pre-contractual liability,[592] to fully recognising the concept and awarding damages,[593] and even in one case, feeling that there was no need to decide on the issue.[594] Furthermore, in cases of alleged pre-contractual liability involving the government or an administrative authority, the Courts have been consistently even less ready to accept the notion either wholly or in part. However, on the 29th of April 2016

<http://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?article=1042&context=jcls> accessed on 2 July 2017

589 Justice Tonio Mallia, 'Pre-Contractual Liability in Malta' [December 2000, Issue 1] Law and Practice, 26-27

590 Miguel DeGabriele 'Pre-Contractual Liability in the Maltese Mixed Jurisdiction: a Comparative Analysis' (LL.B Honours Research Paper, University of Malta 2015) 97.

591 Dr. Paul Micallef Grimaud, *The offer and acceptance in contract law: a comparative legal analysis in the light of modern developments* (1st, University of Malta, Malta 2002) 170.

592 *Cassar vs. Campbell Preston noe* 1971 Commercial Court and *Busuttil vs. Muscat noe*, [28/10/1998] First Hall Civil Court. (Cassar vs Campbell Preston; Busuttil vs Muscat).

593 John Pullen vs. Manfred Gunter Matysik [26/11/1971] Civil Court, First Hall. (Pullen vs Matysik)

594 Dr. Biagio Giuffrida pro et noe. vs. Onor. Dr. George Borg Olivier et [3/3/1961] 131 Court of Appeal, Civil, Superior. (Giuffrida vs Borg Olivier).

the matter was finally put to rest by the Court of Appeal in the case ***Av. Peter Fenech noe vs Dipartiment tal-Kuntratti***[595] when it positively upheld the existence of *culpa in contrahendo* under Maltese law and consequently went on to find a governmental body liable for pre-contractual damages. The judgement has been hailed a landmark which will shape commercial relations for years to come and which will surely pave the way for further recognition by Maltese courts of the contractual basis of the notion of pre-contractual liability.[596]

2. The facts of *Av. Peter Fenech noe vs Dipartiment tal-Kuntratti*

2.1. Case 972/2005/1

The Civil Court, First Hall, on the 3rd of March 2006, established that a specifically formed consortium, on whose behalf the case had been brought, had been unreasonably disqualified from the tendering process for the provision and installation of a Traffic Management Information System. The Court ordered that the Department of Contracts reinstate them in the tender process as though they had never been disqualified. Aggrieved by the decision, the governmental department filed an appeal and on the 27th of June 2008 the Court of Appeal confirmed the First Hall's decision.[597]

2.2. Case 977/2009/1

Distraught by the Department of Contracts' conduct, the consortium initiated a new set of proceedings in front of the Civil Court, First Hall claiming that they suffered pre-contractual damages as the defendant had negotiated with them in bad faith. The plaintiff contended that the defendant's liability arose from the fact that notwithstanding that the court in the abovementioned judgement had found in favour of the consortium,[598] the defendant still failed to re-establish it in the tender process as should have been done, and to make matters worse, as the case remained pending in front of the ordinary courts; the tender was adjudicated in favour of another bidder.

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[595] Av. Peter Fenech, ghan-nom u in rappresentanza tal-Consortium Norcontrol IT Limited Ericsson Microwave Systems AB vs. Dipartiment Tal-Kuntratti, [29/04/2016] 977/2009/1 Court of Appeal, Civil, Superior. (Norcontrol IT Limited Case).

[596] Dr Peter Fenech 'Court of Appeal delivers Landmark Judgement: Right to Pre-Contractual Damages Recognised' [2016]<http://www.independent.com.mt/articles/2016-05-23/local-news/Court-of-Appeal-delivers-landmark-judgment-right-to-pre-contractual-damages-recognised-6736158187> accessed on 2 July 2017.

[597] Norcontrol IT Limited Case (n 11).

[598] ibid.

When examining the nature of the case, Judge McKeon explained that '*m'hijiex azzjoni ghal danni kontrattwali proprju ghaliex il-partijiet qatt ma waslu ghal relazzjoni ex contractu bejniethom.'* He then expressed certain reservations as to the existence of *culpa in contrahendo*, especially in the field of governmental liability:

> *'In kwantu jirrigwarda pre-contractual liability, irid jingħad li l-eżistenza ta' dan l-istitut fil-liġi tagħna għadu dubbjuż u mhux ben definit. Dan l-istitut ma ġiex introdott fil-Kodiċi Ċivili tagħna bħal ma sar f'pajjiżi oħra bħall-Italja u l-Ġermanja. Kien hemm kawżi fejn il-qrati tagħna daħlu f'din il-materja iżda ma jistax jingħad li l-qrati tagħna ħadu posizzjoni ċara, netta, definita u inekwivoka għaliex tidher b'mod ġenerali r-riluttanza tal-qrati tagħna li jaċċettaw b'mod inkondizzjonat materja li mhix kodifikata.'*[599]

The Court then proceeded to quote almost all previous local judgements dealing with the issue of pre-contractual liability in an attempt to extrapolate the principles that had been propounded by local judges over the years. Starting with ***Giuffrida vs Borg Olivier***,[600] the first case generally understood to have introduced the idea of pre-contractual liability in Malta, the judge explained that the burden of proof in such cases is on the plaintiff who must bring evidence of bad faith on the defendant's part. It was held that were *culpa in contrahendo* to be accepted in the Maltese legal system, the liability of the Government would have amounted to *'dik biss tar-rifuzjoni ta' certi danni konsistenti fil-mizura ta' dak li jissejjah interess negativ.'*[601] All the same, the Court went on to conclude that the doctrine had no bearing on the case in question as governmental discretion when negotiating contracts could not be questioned unless by a judge sitting in an administrative tribunal.

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[599] As with regards to the pre-contractual liability, it must be said that the existence of this section of the Maltese Law is still dubious and not clearly defined. This section was not introduced in our Civil Code as was done in other countries like Germany and Italy. There nearly were instances where the Maltese Courts got involved in this matter but no clear, definite and unequivocal position was taken by the Maltese courts, because it is clearly conveyed that they do not accept, in an unconditional way, material that is not codified in the Laws of Malta.

[600] (Giuffrida vs Borg Olivier) (n 10).

[601] The general principle that an unjust or capricious revocation makes its author liable for damages incurred by the counterparty in the measure of 'negative interest.'

Judge McKeon then proceeded to explore the decision by the Court of Appeal in ***Pullen vs Matysik***[602] where the plaintiff's request for pre-contractual damages was accepted. It was decided that the defendant's conduct as he entered negotiations with the plaintiff for the lease of a boutique located on the former's hotel premises and allowed negotiations to reach an advanced stage to the extent that the agreement was almost finalised, yet then went on the rent out to third parties; illustrated bad faith on his part. The defendant's actions had led the plaintiff to acquire a legitimate expectation that he was to obtain the lease and was thus found liable in tort for his conduct which amounted to culpa as envisaged under Article 1031 of the Civil Code.[603] The Court held that compensable damages '[…] are those flowing from the breach by the defendant of his obligation arising from a valid agreement *de ineundo contractu*.' Damages given were limited to the actual losses incurred by the plaintiffs up to the time that the negotiations broke down, consisting in actual expenses incurred or depreciation of material or otherwise however, they did not include any profits which would have been derived from the concession of the boutique.

A contrario, Judge McKeon even explored the *rara avis* judgements of ***Cassar vs Campbell-Preston*** and ***Busuttil vs Muscat***[604] in which the Courts had rightly held that the concept of pre-contractual liability did not form part of the Maltese legal system as this would amount to an impediment to trade.

The most nuanced approach to pre-contractual liability as afforded in the landmark judgement ***Grixti vs Grech*** was also discussed.[605] According to this case, two-pronged requirements present the ideal scenario whereby *culpa in contrahendo* can develop and find consistent application in Maltese law. Firstly, one party must have incurred, in good faith, certain expenses with the expectation of a formal agreement between him and the other contracting party. Secondly, the other party must have, capriciously or almost in bad faith, but not necessarily maliciously or fraudulently, terminated negotiations at a stage where the reciprocal consent of the parties were identical as to the essential conditions of the contract and that the contract was not perfected because of this conduct. Notwithstanding this seminal reasoning, the court dismissed the action of the plaintiff because none of the requisites for the action were met.

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[602] (Pullen vs Matysik) (n 9).

[603] Chapter 16 of the Laws of Malta, Civil Code, Article 1031, "Every person, however, shall be liable for the damage which occurs through his fault."

[604] (Cassar vs Campbell Preston; Busuttil vs Muscat) (n 8).

[605] *Elia Grixti vs. Mark Grech* [3/04/1998] 222/98 Civil Court First Hall.

Moreover, in ***Portelli vs Falzon*** it was established that whoever enters into negotiations with another with the intention of concluding a contract can allege that he has been 'unfairly treated' and then request damages under the notion of pre-contractual liability. In this case however, the request was not made and the circumstances also did not point towards misconduct on the part of the defendant. In order for one to request pre-contractual damages he must prove the unjustified termination of negotiations in a manner whereby '*l-aġir ta' min waqqaf innegozjati irid ikun ekwivalenti għal dolus.*'[606]

By contrast, in ***Seguna vs Kunsill Lokali Zebbug***[607] the First Hall, Civil Court, found the Government to be pre-contractually liable on the same approach as it held in the ***Grixti* case**. Notwithstanding this forward way of thinking, the Court of Appeal agreed that even though there was abuse by the Local Council, this could not amount to pre-contractual liability since the issue was to be dealt with under administrative law. The Court hence, distinguished between pre-contractual liability and abuse of administrative power:

> *'[…] f'każ ta' abuse of administrative discretion, kif inhu l-meritu ta' dan il-każ, il-materja mhix waħda ta' pre-contractual liability, iżda ta' abbuż ta' poter minn min ikollu funzjoni amministrattiva. Meta persuna tigi mċaħda minn kuntratt jew possediment iehor bi ksur tal-ligi minn korp jew uffiċjal amministrattiv, dan ta' l-aħħar ikun responsabbli ta' delitt jew kważi-delitt u jrid jirrispondi għad-danni kollha reali li l-aġir tiegħu jkun ikkaguna. Ir-responsabbilita` pre-kuntrattwali topera meta tnejn minn nies jidħlu f'kuntratt direttu f'negozjati għal ħolqien ta' kuntratt, u wieħed minnhom iwaqqaf dawk il-kuntratti mingħajr ġustifikazzjoni. Is-sitwazzjoni hi differenti meta organu jew ufficjal munit b'poter amministrattiv hu moghti diskrezzjoni fl-ezercizzju ta' dak il-poter, jaġixxi b'mod abużiv bi 'ksur' tal-poteri diskrezzjonali tiegħu.'*[608]

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[606] The behaviour of he who founded the negotiations for the contract must equivalently amount to dolus.

[607] *Phillip Seguna vs. Kunsill Lokali Zebbug* [03/10/2008] 934/1998/1 Court of Appeal Civil, Superior.

[608] In the case of abuse of administrative discretion, as was the case here, the dispute was not on the matter of pre-contractual liability, but on the abuse of power from a person of administrative functions. When a person is denied from another contract or possession through a breach of law from an administrative body or official, the latter of which would be responsible for having committed a crime or quasi-crime, and must be answerable for all damages caused through his behaviour. Pre-contractual responsibility operates on the grounds of when people enter a

In ***Vassallo Builders Limited vs Serracino Inglott*** the Court highlighted the importance of differentiating between a call for offers or that known as the tendering process and the contract of works. The juridical relations between the two are not the same, and thus, should not be considered as such.

> *'... cioè waħda li tikkonsisti fil-proċedura determinata li twassal għall-konklużjoni tat-trattattivi dwar is-sejħa għall-offerti u l-oħra sostantiva li tikkonsisti fin-negozju proprju li jwassal għar-relazzjoni ġuridika attwali u l-kuntratt finali bejn il-partijiet dwar ix-xogħol, servizzi jew forniturita' oġġetti rikjesti.'*[609]

After analysing all of the above Judge McKeon went on to decide that the case in question did not result in *culpa ex contractu* or *extra contractu*, nor did it result in *culpa aquiliana*, *culpa ex delicto* or *dolo* or even abuse of administrative discretion on the part of the Department of Contracts. Moreover, neither could the defendant be found liable for damages in favour of the plaintiff for being excluded from the tender process *de qua*.

On the other hand, the Court of Appeal on the 29th of April 2016 drew on the observations of the Commercial Court in ***Pullen vs Matysik*** and overturned the decision of the First Hall, holding that when parties enter into negotiations with the intention of binding themselves by means of a contract, a contract is created. This is not the contract being negotiated by the parties but an agreement *de ineundo contractu* which binds the parties to negotiate in good faith and not to withdraw from negotiations for a reason not valid at law.

> *'Ġà ngħatat dikjarazzjoni ġudizzjarja, fis-sentenza li temmet il-kawża numru 972/2005, illi ma kienx hemm raġuni tajba u illi d-Dipartiment mexa ħażin meta warrab l-offerta tal-Konsorzju, għax warrabha għal raġuni li ma tiswiex fil-liġi. Dan huwa in-nuqqas, waħdu, għax huwa ksur ta' patt kuntrattwali, inissel responsabilità mingħajr*

negotiations for the creation of a contract and one party cancels the contract without reasonable justification. The situation is different when a body or official, bestowed with administrative power and is given discretionary power in the carrying out of his duties,acts in an abusive manner by breaking such power of discretion that he has.

609 The conclusion reached by the court was that no liability existed.

> *il-ħtieġa ta' dolus jew culpa proprji għal responsabilità ex delicto vel quasi li fittxet u ma sabitx l-ewwel qorti.'* [610]

The Court went on to explain how in cases involving a call for offers for a public contract, a valid reason to refuse or reject tender applications would be due to a lack of observation of tender conditions, unfavourable conditions or more advantageous offers by third parties. If either party does not comply with these obligations, the party at fault will need to make good the damages suffered by the other party:

> *'Il-kejl tad-danni fil-każ ta' culpa in contrahendo huwa dak magħruf bħala 'l-interess negativ', i.e. mhux dak li kien jikseb l-attur li kieku ngħata l-kuntratt, iżda dak li ma kienx jitlef li kieku ma ressaqx l-offerta.'*[611]

The Court substantiated its decision on the basis of the contractual nature of *culpa in contrahendo* as developed by the German courts in the 1911 judgement ***Reichsgericht - Linoleumrollen-Fall***. In this case a person had entered a store to purchase a carpet and was knocked down by a roll of linoleum, which a store employee had carelessly dropped on her. This action could not be successful if it were to be classified as arising out of a tort since the applicable provisions of the B.G.B. [612] At the time stipulated that an employer cannot be found liable in tort for the damage caused by his employee in absence of proof of *culpa in eligendo*. The German court avoided this obstacle by explaining that a legal relationship came into existence between the parties in preparation for a purchase and that this relationship bore a character similar to a contract which produces legal obligations.

The Court of Appeal explained how even though the facts of the case were different:

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[610] It has already been judicially declared in the sentence which decided case number 975/2005 that there was no justifiable reason for such action and that the Department acted wrongfully when the offer of the Consortium was disregarded. Such disregard was deemed to be not in accordance with the Laws of Malta. Therefore, such negligence on its own is enough to be considered as a breach of the contractual pact and bring about legal responsibility without the requirement of *dolus or culpa* which normally are needed for responsibility of *ex delicto vel quasi*, which the First Court did not find.

[611] The measurable damages in the case of *culpa in contrahendo* are those known as 'the negative interest', i.e. not that which the actor would have gained in the case of the success of the contract, but rather the damages which would have been lost had the contract never been offered in the first place.

[612] Bürgerliches Gesetzbuch (German Civil Code).

> *'is-sisien loġiċi tal-azzjoni tallum huma l-istess: hekk kif il-Konsorzju fuq stedina tad-Dipartiment għamel offerta, inħolqot relazzjoni kunsenswali fiehim taċitu de ineundo contractu – bejn il-partijiet fis-sens illi l-offerta titqies kif imiss u ma tiġix imwarrba jekk mhux għal raġunijiet li jiswew fil-liġi. Ir-responsabilità ta' min jonqos li jħares il-kondizzjonijiet ta' dan il-patt taċitu hija r-responsabilità ta' min jonqos li jħares patt kuntrattwali, u għalhekk hija ex contractu.'*[613]

3. Comments

Forty years after the ***Giuffrida*** **judgement**[614] which seemed to imply that it is difficult for pre-contractual liability to arise when the case involves an administrative authority or the Government itself, the Court in the ***Fenech noe*** **judgement** finally shut the door on this very conservation approach and categorically found the Department of Contracts, a governmental body, liable for pre-contractual damages. While wholly in line with the doctrine of *culpa in contrahendo* as found in the Continental school of thought, a closer look at the outcome of the Court of Appeal's decision as to the quantification of pre-contractual damages illustrates how the application of the doctrine under Maltese law remains faint-hearted.

Originally, the consortium claimed that it was owed seven hundred and fourteen thousand and eight hundred and fifty-one Euro (€714,851) by way of damages. However, on the 5th of November 2015 the applicant reduced its request to the amount of damages due only by way of negative interests: those pertaining to 'sales activities' and 'technical activities' which amounted to a total of seventy-one thousand nine hundred and forty Euro (€71,940). Notwithstanding this, the Court still went on to further reduce the amount of compensable pre-contractual damages to thirty-eight thousand three hundred and forty Euro (€38,340)[615] basing itself on the argument that the applicants had not provided sufficient proof.

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[613] The logical foundations of today's actions are the same: by invitation of the Department, the Consortium made an offer, and a consensual relationship was created, through a tacit '*de ineundo contractu',* between the parties on the grounds that the offer remains as is and will not be disregarded, unless there are reasons due to law present. He who fails to carry out the conditions of this tacit agreement is responsible for breaking the contract and is thus, '*ex contractu.'*

[614] (Giuffrida vs Borg Olivier) (n 10).

[615] '*Taht dawn il-Konsorzju jqis is-sigħat ta' xogħol ta' erba' diriġenti tiegħu sabiex ħejjew l-offerta, spejjeż sabiex ivvjaġġew lejn Malta, spejjeż ta' lukandi u spejjeż sabiex intbagħtu d-dokumenti tal-offerta b'courier. Il-Konsorzju jgħid illi b'kollox dawn is-sales activities ġew jiswew tmienja u tletin elf, tliet mija u erbgħin euro (€38,340).'*

Dr Fenech contends how, while bearing in mind the unpredictable manner in which the Maltese courts had dealt with cases of pre-contractual liability, especially ones which had involved the Government, his focus at appeal stage shifted onto primarily the procuring of 'negative interests' by way of pre-contractual damages for his clients. Notwithstanding the grave reduction in requested damages, the Court still deemed it fit to further minimise these, in what is very likely to be an attempt not to open the floodgates to the institution of court cases suing the government for its wrongdoings.

The judgement remains significant nevertheless. While it is true that the ***Pullen*** and ***Grixti*** **judgements** may have illustrated that *culpa in contrahendo* already had a place in Maltese law, the cases that followed demonstrated that this was not applied in cases where the Government was a party to the suit. In the ***Fenech noe*** **case** the Court did in fact, for the very first time, expressly confirm the existence of *culpa in contrahendo* under Maltese law and went on to find the Government pre-contractually liable for its bad faith during contractual negotiations.

Of further significance is the fact that the Court of Appeal referred to the ***Linoleumrollen-Fall*** **judgement**. The German jurisprudential rule circumvents a quasi-tort rule which is often regarded as undesirable policy wise as even under Maltese law, employers can only be found indirectly liable for the acts of their employees in for *culpa in eligendo*.[616] By classifying the relationship as *ex contractu* and not as *ex delicto* the Maltese Court finally rendered it possible to find a governmental department liable for pre-contractual damages. While the damages awarded may be deemed unsatisfactory, the Court's approach cannot be considered as anything other than a step in the right direction.

4. Concluding Remarks

The term equity in Maltese law bears a dual meaning as a gap-filling device and as a tool to correct the injustice or unfair results flowing from the literal application of law. As to pre-contractual liability, this is to be interpreted in accordance with the former understanding of the word. As a pertinent issue within the realm of private law pre-contractual liability as under Maltese law seems to support the assumption that local judges play an essential role in driving the development of the Maltese legal system and contribute to its mixed nature.[617] While the doctrine of pre-contractual liability was

[616] Kühne, Günther, Promissory Estoppel and Culpa In Contrahendo, in: 10 Tel Aviv University Studies in Law, Tel Aviv 1990, at 279 et seq. <https://www.trans-lex.org/114700/_/k%C3%BChne-g%C3%BCnther-promissory-estoppel-and-culpa-in-contrahendo-in:-10-tel-aviv-university-studies-in-law-tel-aviv-1990-at-279-et-seq/> accessed on 2 July 2017.

[617] B Andò, The Mélange Of Innovation and Tradition in Maltese Law: The Essence Of The Maltese Mix? <https://www.ajol.info/index.php/pelj/article/view/82488> accessed on 2 July 2017. 81.

once seen as an interesting example of the 'pragmatic' attitude of Maltese judges to have recourse to solutions drawn from different traditions in their fulfilment of their gap-filling function, the ***Fenech noe* judgement** has ensured that the existence of the Continental *culpa in contrahendo* no longer remains controversial and fully applies in cases of governmental liability.