Trust and disclosure in european contract law

Confianza e informacion en el derecho contractual europeo

The paper analyses the reasons for a correct formation of the exchange contract in a market economy, in order to safeguard its operation in a competitive sense. In particular, it highlights the importance of protecting the trust of the contracting parties with respect to reciprocal disclosure obligations that prevent the conclusion of asymmetric contracts, which by definition are unfair and inefficient.

KEYWORDS: contract law, competition, duty of disclosure, precontractual liability

En este trabajo se analizan los requisitos para la correcta formación del contrato de permuta en una economía de mercado, con el fin de salvaguardar su funcionamiento en un sentido competitivo. En particular, destaca la importancia de proteger la confianza entre las partes con respecto a sus reciprocas obligaciones, lo que impide la celebración de los contratos asimétricos, que por definición son abusivos e ineficaces.

PALABRAS CLAVE: derecho contractual, competencia, deberes de información, responsabilidad precontractual.

1. Contract and market

Contract law constitutes the fundamental legal pillar that supports the economic structure of the market. Historically, the relationship between contract and market is ancient, dating back to the time before the industrial revolution, when lex mercatoria provided the legal backbone for emerging commercial capitalism, prevailing over Roman law and subject only to canon law. It is, in fact, the ius mercatorum of the municipal society that makes the contract the essential legal instrument for the circulation and accumulation of wealth, marking a radical change of direction compared to Roman law, leaning toward the mere preservation of existing ownership structures (Schumpeter, 1976; Appleby, 2010; Galgano, 2010; Berman, 1985).

However, there were major civil codifications; the first was the Napoleonic Code of 1804 that fulfilled a function for more integral aspects of the market economy. This is evidenced...
by the prevalence of the enlightened concept of private property, finally free from feudal constraints, and the affirmation of the principle of equality among men. This fundamental principle created the necessary conditions for the establishment of a market economy, whose values no longer depended on the subjective status of the contracting parties, now considered equal before the law, but who are left to the free play of economic forces. In this perspective, the introduction of the general category of the contract and of the consensual principle in French Civil Law, in the footsteps of Domat and Pothier, proved to be decisive factors for the increase in trade (Sumner Maine, 1960, 229).

It was, however, an affirmation of a formal but not yet substantial principle of equality. The latter, indeed, came into force with the development of contemporary European constitutionalism, where the content or material of the principles dominate, in order to ensure greater protection of the rights and unity of the legal system.

The idea of substantial equality in contract law within the common law systems was advanced mainly in the United States of America, where the dogma of contractual freedom, understood as the inviolability of the will of the parties (voluntary doctrine), dominating in the 19th century, was attacked by criticism of the liberals based on claims for the social protection of the weaker part of the relationship (Pound, 1909; Atiyah, 1979; Friedman, 1965, 20).

Under current Italian law, art. 3, paragraph 2 of the Constitution translates into the statutory principle of substantial legal equality between the parties, which has as its purpose the removal by the court of the possible distorting effects of contractual freedom caused by disparities in economic power or the imbalance of information between the subjects of the newly-forming relationship. In addition, the principle of substantial equality requires the contractual balance originally shared by the parties to be maintained unaltered, in the execution phase of the relationship. In both cases, it is the clause of good faith or fairness which is the legal instrument that allows the court to provide each contracting party with the prerogative - constitutionally guaranteed - to freely determine their own contractual will and to achieve it with the collaboration due to the other, on the basis of the program agreed upon.

However, the inseparable link between the contract and market arises from the fact that freedom of contract is the legal manifestation of the freedom of enterprise, of which freedom of competition is the pluralistic aspect.

In particular, Article 41 of the Italian Constitution states that “private economic enterprise is free”, adding, however, in the second paragraph, that it “may not be carried out against the social usefulness or in a way that may harm public security, liberty, or human dignity”.

The supreme value of human dignity, on the other hand, is a foundation of the European Union Treaty (Art. 2) and the Charter of the Fundamental Rights of the European Union (art. 1), which has the same legal status as the European Union treaties (art. 6 TEU). Even the freedom of enterprise, which constitutes the fundamental element of the single European Market, is expressly recognized in art. 16 of the Charter of fundamental rights of the European Union, in accordance with Union law and national laws and practices.

Freedom of enterprise is guaranteed by Article 41 of the Constitution only in a socially useful situation. The limitation of social usefulness, in particular, immediately gives rise to the sensitive issue of its concrete specification, which is governed not only by the application of antitrust law, but also and above all by the laws that protect the consumer, who is the “weak” party in contractual relationships with a businessman (see, for example, EU Directive 2011/83,
on consumer rights, as well as EU Directive 2014/17, on real estate credit to consumers).

The constitutional reference to the concept of social usefulness, however, is in line with the social economic model of the market, already devised by the School of Ordoliberalism of Freiburg (Soziale Marktwirtschaft), as explicitly mentioned in the Treaty on the European Union. In fact, Article 3, paragraph 3, of the Treaty on the European Union, states: “The Union shall work for the sustainable development of Europe, based on a balanced economic growth and price stability, on a highly competitive social market economy, which aims at full employment and social progress.” In this regard, article 3, paragraph 1, letter b), of the Treaty on the Functioning of the European Union, states that the Union has exclusive competence in establishing the rules of competition necessary for the functioning of the internal market (see Article 101 of the TFEU).

The concrete expression of the social aspect of the market is found above all in Article 9 of the Treaty on the Functioning of the European Union, according to which “in defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health”, and in the successive article 12 TFEU, for which “in defining and implementing other Union policies and activities consumer protection requirements shall be taken into account” (see also Article 38 of the EU Charter of Fundamental Rights and Article 169 TFEU).

The maintenance and growth of individual and collective well-being, in fact, depends not only on the existence of effective competition between business entities, but also on the protection of each contracting party against the abuses of contractual power that can come from the other. Competition rules and contract rules are therefore in symbiotic relationship and complement each other.

Private market law is the product of this inseparable bond and pursues a dual purpose:

a. the protection of all individuals of contracts considered “weak” because of being part of asymmetric contracts where the economic power of a contracting party is a means of overcoming the other and a source of allocation inefficiencies;

b. protection of individuals, competing entrepreneurs, or consumers, not part of the contract, but who may suffer damage by its execution, so-called antitrust.

From this perspective, it can be said that private law, and in particular contract law, also fulfills a regulatory function of the market, which is no longer the exclusive prerogative of the rules of public law of economy. Indeed, the radical commingling between public interest and private interests constitutes the distinctive mark and at the same time justification of the current remedial system of contract law, particularly in the field of business bargaining. In other words, the civil court is now called upon to orient its decisions on the basis of competitive market values, especially whenever it makes use of its corrective power in a fairly equitable manner, resulting in the heterogeneous integration of the contract.
2. The economic and legal problem of asymmetric contracts

The sales contract is markedly efficient, since, according to economists, under perfect competition, the exchange leads to improvement of the conditions of both parties (Shavell, 2004, 271).

In particular, a contract is mutually advantageous or Pareto efficient when it cannot be modified so as to increase the expected benefit of either of the parties.

This is mainly due to the fact that the parties, in a perfectly competitive market, are in a position to assess the risks inherent in the contract in an optimal way, so that it is reasonable to conclude the deal under given conditions (first of all, the price). From this perspective, the full information of each contracting party on the nature and consequences of his/her choice is crucial for maximizing the profit he/she can derive from the economic operation.

A contract with asymmetric information, for which one party had more detailed information about the essential points of the agreement, is, therefore, inefficient.

However, as economic entities, which are also legal entities, they tend to behave opportunistically, i.e. pursuing purely selfish goals, they are naturally inclined to omit or falsify the information they possess (Williamson, 1985 43). In this regard, information economy studies how to prevent opportunistic behaviour, implemented both in the pre-contractual phase (adverse selection) and in the post-contractual phase (moral hazard). These behaviours undermine the trust that each contracting party must have with regard to the other.

The transaction costs, namely those required to conclude the contract (costs of obtaining information, legal fees, taxes, etc.), together with the lack of relevant information, caused by reluctance of one party towards the other, as well as the presence of monopolies in the market, which prevent finding satisfactory alternatives on the supply side, are the most incisive factors of inefficiency or inadequacy of contracts. According to the famous theorem of Ronald Coase, in fact, in the absence of transaction costs, it is possible to reach an efficient allocation of resources through bargaining between producers of externality and victims (Coase, 1960, 15).

The legal problem of contractual asymmetries in the perspective of civil law results in the need to ensure awareness of contractors’ choices regarding the construction of the contractual arrangement or the acceptance of a regulation unilaterally drawn up by one of them; in monopolistic markets it denotes the need to ensure the fairness of contractual terms according to competitive parameters.

Therefore, within the general category of contractual asymmetries, it is possible to distinguish two sets of asymmetries:

a. economic asymmetries, arising from situations of economic or moral submission or economic dependence;

b. informational asymmetries that hinder the perception of the factual reality of one of the parties before the conclusion of the contract.

Taking advantage of a part of your position of economic superiority or fraudulent misrepresentation to the detriment of the other causes incorrect pre-contractual behaviour.

In particular, the problem of asymmetric information essentially concerns the formation of
contracts entered into within market situations of the product characterized by a competitive bid, that is, by the presence of a number of companies offering substitutable goods or services from the demand side, so that the other party (company or consumer) can find satisfactory alternatives to a given contract proposal.

Indeed, whether it is individually negotiated contracts or standard contracts, every time the offer is competitive, asymmetric information in terms of the conditions and contractual prerequisites can result in unfair exchange.

The inequality of bargaining power, therefore, is due to the different degree of information of the parties at the time the contract is concluded.

In contractual cases subject to individual negotiation, the incorrect behaviour of one of the parties, which may lead to asymmetric information legally relevant, is a deceptive act aimed at affecting the contractual terms.

This activity may also consist of a wilful omission, that is to say in unfair behaviour because it is reticent in relation to circumstances relevant to the conclusion of the contract or for the conclusion of the contract under given conditions.

Unfair pre-contractual behaviour is thus contrary to the principle of freedom of competition, which, instead, poses the question of awareness of contractual choice on the demand side. In this perspective, pre-contractual liability (see Article 1337 of the Italian Civil Code), which is the typical remedy for protecting the negotiating freedom of the weak party, focuses on ensuring the correct disclosure of the essential points of the contract to the party.

In particular, in individually negotiated contracts the duty of fairness in negotiations is deeply affected by the personalization of the pre-contractual relationship, which determines the relevance of the circumstances not only objective, but also subjective in relation to determining the contractual program, and hence the extent and content of the duty of disclosure borne by the parties.

In this hypothesis, the crucial point for the interpreter is identification of the information that each party has to make known to the other so that it can properly measure its own interests and thus the benefit of the deal that is about to conclude.

In this regard, some important studies of economic analysis of law conducted by American scholars on the duty of disclosure have highlighted the fundamental difference between information deliberately acquired, for which the bearer has incurred costs, and casually acquired information, without incurring any cost for obtaining it (Kronman, 1978, 1 pp.).

Now, concerning the specific investments incurred by one party to obtain relevant information, it can be concluded that a rule that forces one another to disclose to the other, under penalty, for example, the cancellation of the contract, would be inefficient. In fact, the gathering of information would be discouraged as it could increase the value of the object of the contract, contrary to what should happen in a competitive market.

Contrary to individually negotiated contracts, the formation of mass contracts is characterized by the depersonalisation of the pre-contractual relationship; therefore, information obligations essentially translate into purely formal obligations that aim to ensure the transparency and effective understanding of the general conditions of the contract and the means for protecting the consumer. The necessary uniformity of the contractual conditions therefore results in uniformity of the information provided to the consumer. For example, the declared objective of EU Directive 2014/17 is to foster the development of a transparent real
estate credit market, given that the behaviour of lenders, not based on this principle, creates an unfair advantage in their favour in terms of high interest rates (i.e. predatory lending), causing consumer mistrust.

The framework of the analysis changes radically in markets with collusive oligopolies or by (almost) monopoly situations where the consumer or, more in general, the weak part of the contractual relationship has no chance of finding satisfactory alternatives to the company’s offer under unfair terms.

Thus, we find ourselves in cases of abuse of a dominant position by the contract or of abuse of economic dependence in relationships between companies where compliance of the obligation of the strong contracting party to inform would not, however, serve to protect the interests of the weak contracting party, who has no choice.

3. Duties of disclosure, trust and relational contracts

It has already been mentioned that in individually negotiated contracts the relationship between the subjects of the negotiation is a personalized relationship, since it presupposes identification of the authors of the exchange of proposals and counterpropositions.

The negotiation is therefore individual, in the sense that a prominent role is assigned to the cognitive and relational capacities of the parties.

The judge applying the clause of good faith (see Article 1337 Italian Civil Code) to the conduct of the parties in the course of individual negotiations must necessarily take into account the history and the quality of the relationship between them prior to the conclusion of the contract and, above all, of their subjective conditions. It follows that the existence of a trust relationship between the parties, for example due to a family relationship or previous contractual relationships between them, has a decisive influence on the identification of the duty of disclosure incumbent upon the contracting parties.

Whoever deals with a party he already knows is honest and reliable must count on the fact that he will be particularly careful to reveal as much information as is needed and/or useful in assessing the economic benefit of the deal. Likewise, anyone who engages in negotiations with a party he or she knows is weak or economically or morally apprehensive is bound to reveal to him all the information that may affect his will, keeping in mind the particular situation of the weak party.

In both cases, the information must address the possible disadvantages that may arise from the contractual conditions to the weak part of the relationship, and not the possible advantages that the party to which the duty to provide information can derive from it. For example, if X is obliged to disclose to Y the fact that the land he is going to buy from him has become a buildable area, asking him to reflect on the fairness of the price he proposes in relation to the average price already used for the sale of other lots in the same area, X will not be obliged to inform Y of the fact that he has already contacted a contractor willing to repurchase the same building lot at a price higher than that in the current negotiation.

This is what institutional economics teaches when, abandoning the traditional concept of
the contract as an instrument independent of the subjective context from which it arises (which would allow the consistent application of uniform legal rules), the idea of a relational contract is assumed, since the individual moves within a world of relationships, characterized by a continuous evolution of the relationship between the parties within the contractual dynamic (Williamson, 1979, p. 233).

It is precisely with reference to this model of relational contract that the general clause of good faith or fairness takes on central importance, pending the indeterminable a priori legal standards of behaviour. In other words, the duty of information for forming an efficient and pro-competitive contract is necessarily calibrated on the basis of the particular relationship that binds the subjects between whom an “economic contact” is established.

The circumstances of the concrete case, in the hypothesis of negotiated contracts, in the light of which the judgment of good faith in contrahendo, are essentially (but not limited to) subjective circumstances.

In this regard the English experience is exemplary, in all cases in which, for example, it attributes importance to the remedy of equity in the cancellation of the contract for undue influence, in cases of psychological or moral subjection of one party against the other (Enonchong, 2012).

In particular, it is a relationship of trust and confidence that determines the undue influence, as in the case of the guarantee (personal or real) taken on by a relative (wife, brother, father) of the principal debtor to the bank for payment of the loan contracted by the latter. In this case, it is only independent legal advice on the consequences of an act that can rule out the undue influence, which is based on a pre-existing confidential relationship between the debtor and the guarantor (presumed undue influence), of which the bank takes advantage of to force manifest disadvantage on the weak part (Sethupathy, 1994, 164).

Likewise, taking advantage of a part of the subjective condition of the ignorance or poverty of the other can lead to annulment of the contract for unconscionability.

According to German law, Paragraph 138 (2) BGB seems oriented in the same direction, according to which the contract is null and void if the benefit and consideration are manifestly disproportionate and if one of the parties had taken advantage of the “state of necessity, inexperience, lack of discernment or the significant weakness of the other’s will”.

French law, instead, recognized the same concepts through the jurisprudential use of the concept of fraudulent misrepresentation, whereby the contract was deemed annulable by the judges when a contractor had taken advantage of advanced age, serious illness, adolescent inexperience or the state of need of the other, encouraging him/her to take hasty decisions, not consulting his/her family or lawyer, or minimizing or concealing the relevance of the contract (Kötz, Patti, 2017, 191). Following the reform of art. 1137, paragraph 2 of the Civil Code of 2016, which now states that it constitutes wilful misconduct to deliberately withhold any information that was known to the determining character of the other party.

However, it seems that the above-mentioned Anglo-Saxon rulings have been taken into account in the drafting of art. 3.2.7 of the Unidroit Principles of International Commercial Contracts (PICC) and art. 4: 109 of the Lando Commission’s Principles of European Contract Law (PECL), where the contract can be annulled, respectively, for unilateral “excessive and unjustified advantage” and for “unfair profit or inequitable advantage”.

In particular, Art. 3.2.7 of the Unidroit Principles, under the heading Gross disparity,
provides that “A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage. Regard is to be had, among other factors, to (a) the fact that the other party has taken unfair advantage of the first party’s dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill, and (b) the nature and purpose of the contract. Upon the request of the party entitled to avoidance, a court may adapt the contract or term in order to make it accord with reasonable commercial standards of fair dealing”.

On the other hand, Art. 4:109 of the PECL, headed Excessive benefit or unfair advantage, states that “A party may avoid a contract if, at the time of the conclusion of the contract: (a) it was dependent on or had a relationship of trust with the other party, was in economic distress or had urgent needs, was improvident, ignorant, inexperienced or lacking in bargaining skill, and (b) the other party knew or ought to have known of this and, given the circumstances and purpose of the contract, took advantage of the first party’s situation in a way which was grossly unfair or took an excessive benefit. Upon the request of the party entitled to avoidance, a court may if it is appropriate adapt the contract in order to bring it into accordance with what might have been agreed had the requirements of good faith and fair dealing been followed”.

Very representative in this regard is one of the examples provided in the commentary of art. 4: 109 of the PECL: “X, who is an uneducated person and has no experience in business, inherits a certain property. He contacts Y, who offers to buy it from him for a price much lower than the actual value, telling X he must sell it quickly or lose the opportunity. X accepts without consulting anyone else. X can cancel the contract”.

Almost comparable to art. 4:109 PECL is art. 7:207 (Unfair exploitation) of the Draft of the Common Frame of Reference of European Private Law, conceived by the European Commission as an instrument to ensure the uniform application of the same concept in different territorial areas (Alpa, 2016, 325).

The above-mentioned principles also highlight the possibility of the court correction of the unbalanced or unfair contract as an alternative to annulment, just as in the Italian law with the use of compensation for the damage caused by wilful misconduct in order to rebalance the relationship.

In Italy, however, an action for damages based on wilful misconduct, even if it is useful in eliminating the consequences of the breach of the rule of fairness, does not, however, serve to deal with psychological situations based on personal relationships existing between the parties, especially if familiar or affective.

The malicious intent, in other words, does not yet work in human terms, in the sense that it fails to convey actions, both for annulment as well as for compensation, based on informational asymmetries resulting from omissive, deceptive behaviour, detrimental for the “weak” part.

Moreover, in Italy termination for infringement is, on the one hand, based on the state of need, which in principle does not coincide with subjective situations of ignorance or inexperience or of simple moral subjection on the part of the disadvantaged; on the other, that of the need for the services received is less than half the value of the services rendered at the time of the conclusion of the contract. Article. 1437 of the civil code, for its part, states that “reverential fear only is not reason for cancellation of the contract”. This constitutes a serious
obstacle to the significance of the psychological or moral state of one of the contracting parties, which can gain weight only if the result is the inability to act or discern and will (Articles 1425 and 428, second paragraph, civil code). Furthermore, pursuant to art. 1450 of the civil code, the corrective action of the court may only take place at the request of the contracting party against whom the termination is sought.

It is then up to the fairness clause based on mandatory disclosures regarding the benefit on the side of one party with respect to protecting the interests of the counterparty, every time in which the former knows the economic or moral intimidation of the other.

Considerable effort has been made in this direction by the preliminary draft of the European Contract Law Code drawn up by the Academy of European Private Lawyers. In fact, in Article 7, paragraph 1, under the heading Duty of Disclosure, it is established that “During the negotiations each party has the duty to inform the other of any factual or legal circumstance that he or she must be aware of, allowing the latter to understand the validity and benefit of the contract”.

The rule, as already cited in art. 1137, paragraph 2, of the French Civil Code, however, errs, as it is not concerned with the relational dimension of the negotiated contract and the subjective states of the parties, nor does it take account of the object of the duty of disclosure, which certainly can not relate to the advantages the party hopes to obtain from the contract and, in particular, from its own services. Let us try, then, to reformulate the rule (indicating our additions in italics): “During negotiations each party has the duty to inform the other of all circumstances of fact and law, which he or she must be aware of, which allows the latter to realize the validity and benefit of the contract, “if from this, loss occurs, taking into account, in any case, the nature of the parties, their family or affective relationships and previous binding relationships between them or others, which still binds them”.

4. Conclusions

Reconstructive lines of European contract law allow us to assert that the fairness and efficiency of legal rules are closely related current-day issues, although they may seem contrasting.

European law, in fact, shows unequivocal signs of favouring the fairness and equity of contractual exchanges and, more broadly, the correctness of the conduct of those involved in an economic operation aspiring to assume a specific legal status.

In this respect it is significant that Art. 2, paragraph 2, letter e) of the Italian consumer code recognizes the fundamental rights of consumers and users to fairness, transparency and equity in contractual relations.

The concept of man as a relational being is at the core of contract law, where the appeal to fairness and equity is inspired by the clear intention to promote and protect business ethics.

The notion of fairness calls for a procedure of contract integration (see Article 1374 of the Italian Civil Code), which enhances the circumstances of the case in order to establish a disciplinary relationship appropriate to the protection of the interests at stake, as they emerge from an interpretation in good faith of the will of the parties (art. 1366 Italian civil code). But equity is - as Aristotle stated in his Rhetoric - a criterion for interpretation, like fairness, since it allows attention to be given to the spirit of the law, rather than to the letter (Aristotle,
Nicomachean Ethics, V, 1136 to 1138 a). The equitable argument used in the interpretation of pactional normalization aims, precisely, to suggest or to motivate the attribution of meaning that best brings about the balance of conflicting interests.

The task of fairness is to commensurate the behaviour of the parties to a pattern consistent with the fundamental principles of the norm, while equity allows the particular requirements not made explicit by the provision of the law to be taken into account, ensuring that the will of the parties is taken into account. However, since fairness and equity are both in full agreement between the sources of integration of the contract, the boundary line between the two concepts is significantly thin when interpreting the specific facts to reach a solution to the conflict of economic interests according to the will of the contracting parties.

Basically, fairness is a standard of conduct of the instrumental parts for achieving a fair reconciliation of the interests at stake. There is a very important consequence: unfair behaviour can only lead to an unfair or unjust contract. An unfair contract, in this perspective, is not able to fulfil its function, namely the settlement of the conflict of economic interests through the self-regulation agreed upon by them.

Therefore, the concrete structure of the parties’ interests, in a balance that takes into account of the legitimate aspiration of each of them for maximizing the profit generated by the economic operation, in full respect of the values of the human person, is obtained only by re-reading the contract in light of the principle of fairness. In this respect, fairness, as an assessment of the conduct of the parties of a mandatory relationship (see Articles 1175 and 1375 Italian Civil Code), has become, in recent years, a real instrument of tangible integration of the contract, in order to guarantee the so-called “Fairness of the exchange”, to be identified with the concept of equity, that aequitas singularis of medieval ancestry, which today is firmly backed up every time the court points out the factual aspects of the law that applies, attributing decisive insight into the subjective qualities of the parties and to the “history” of their relationships (the so-called concrete circumstances of the case) for the interpretation of the negotiating statements and the rebalancing of the respective contractual positions.

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