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LEGAL STATUS OF HEADS OF AGREEMENT IN CHILE

El estatus legal de los *heads of agreement* en Chile

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Abstract

This article refers to the legal status of the Heads of Agreement in Chile. Since these legal instruments are widely used in Chile, and they do not have specific regulations, there is the need for construing an argument for understanding their legal effects, meaning that they may fall under torts or contractual regimes. The article will conclude that, in order to determine the legal regime applicable to heads of agreement, judges will need to review whether the consent was formed.

Keywords: *heads of agreement; contractual liability; torts; consent*

Resumen

Este artículo se refiere al estatus legal de los *heads of agreement* en Chile. Dado que estos instrumentos jurídicos son ampliamente utilizados en Chile, y que no cuentan con una regulación específica, es necesario construir una argumentación para entender sus efectos jurídicos, lo que significa que pueden encuadrarse en regímenes extracontractuales o contractuales. El artículo concluirá que, para determinar el régimen jurídico aplicable a los *heads of agreement*, los jueces tendrán que revisar si el consentimiento se ha formado.

Palabras Clave: *heads of agreement; responsabilidad contractual, daños extracontractuales, consentimiento*

I. INTRODUCTION

Heads of agreement play a significant role in business development and, in general, in commercial activity. Broadly, they set the essential terms of the bargain in commercial transactions. With heads of agreement, parties in a business relation agree on the basic terms of their negotiation and keep the other aspects open to be agreed in a definitive contract.

There are many reasons why parties may enter into a preliminary agreement. From a commercial perspective, parties may want to give effect to their negotiations or ensure, for example, exclusivity and confidentiality. Although preliminary agreements are more frequent in common law systems, they have also become an internationally standard practice, and have

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been adopted in other countries that are not common law systems. In particular, industries based on resource exploration and exploitation, and energy infrastructure development, have adopted these preliminary agreements. The reasons may vary, but it is more likely that international companies feel more confident with these known documents.

The indiscriminate use of the preliminary agreements in non-common law legal systems can lead to problems in jurisdictions with different practices and traditions. The enforceability and validity of an agreement also differ from one jurisdiction to the other. This, consequently, demands the analysis of the effect that heads of agreement have in each relevant jurisdiction.

Chile is also part of the trend in this matter. There is widespread use of foreign legal instruments without considering the consequences and legal effects. Heads of agreement are just one example of them. The questions that arise then are: what is the legal status of the heads of agreement in Chile? How do they interact with the different legal instruments of the system? What are their effects? Do they generate contractual liabilities or not?

These questions are critical to adopt a foreign practice responsibly. Lawyers and all the participants of the industries that use these preliminary agreements should be aware of what they are doing and the effects or the legal ramifications of their actions, when entering into these agreements in Chile. This article analyses the legal status of heads of agreement in the Chilean legal system and provides an answer to the questions previously formulated. In doing so, the article offers some general context regarding the heads of agreement and, in particular, the context of heads of agreement in Chile. Then, the analysis considers whether heads of agreement in Chile are contracts or preliminary negotiations. The main consequence of this analysis is that if heads of agreement were considered preliminary negotiations, the applicable regime is the one of torts or the extra-contractual regime. On the contrary, if they are contracts, the applicable regime is the one of contracts. As will be explained, there are quite important differences between the two regimes. Further, this article discusses the significances and the relevance of the distinction between understanding heads of agreement as torts or as contracts and, finally, it concludes that the element that triggers the distinction between one option and the other within the Chilean legal system is whether the parties have consented to create obligations.

II. HEADS OF AGREEMENT

Commercial transactions widely use heads of agreement in the preliminary stages of negotiations.[1] In fact, many sectors of the economy use the heads of agreement as a regular practice.[2] Joint Ventures are not the exception to this rule.[3] In this regard, drawing attention to understanding what the heads of agreement are and their main uses seems necessary to appreciate their role in the context of, for instance, joint ventures and, to some extent, in every

[1] HOMBURGER & SCHUELLER (2002), p. 512.

[2] HOMBURGER & SCHUELLER (2002), p. 512.

[3] SCHWARTZ & SCOTT (2007), p. 694.

other sector of the economy where they are used. In principle, well-drafted heads of agreement can be a very useful tool, while an unclear one can be a source of future litigations.[4] Consequently, an adequate understanding of the legal nature and effects of the heads of agreement is critical for lawyers to give good legal advice.[5] Part II will explain what is meant by 'heads of agreement'.

2.1 What are the Heads of agreement?

Heads of agreement is a type of preliminary agreement.[6] Depending on the jurisdiction, preliminary agreements can also be Memorandum of Understanding, Letters of Intent, Term Sheets, among other terms. Regardless of the name, a heads of agreement is a device that precedes a definitive agreement, and whose purpose is to enhance the negotiation phase in commercial transactions.[7] They are one of the first stages of the lifecycle of a commercial transaction.[8]

Although these agreements are currently broadly used, this has not always been the case. In common law jurisdictions, the courts have not always accepted the enforceability of preliminary agreements.[9] They were considered as *agreements to agree*, and they were even considered as absurd and contradictory.[10] However, in the middle of the 20th century, courts started to recognise these instruments and to give them effect.[11] In civil law jurisdictions, the source of the *agreements to agree* is not clear, and there are many discussions regarding this topic.[12] Nevertheless, at the present time, these jurisdictions extensively use the promise agreement as a form of preliminary agreement.[13] On the other hand, heads of agreement are also used in civil law jurisdictions. Moreover, some civil law jurisdictions have expressly regulated this kind of agreement.[14] Consequently, although in the beginnings there were some hesitations in its use, today both civil law and common law jurisdictions are familiar with this institution.

[4] HOMBURGER & SCHUELLER (2002), p. 535.

[5] WOLFF (1994), p. 301.

[6] O'CALLAGHAN & BERNAU (2013).

[7] GOSFIELD (2004), p. 55.

[8] GOSFIELD (2003), p. 100.

[9] FOREMAN (2014), p. 15.

[10] FOREMAN (2014), p. 17.

[11] FOREMAN (2014), p. 18.

[12] ABELIUK (1971), p. 22.

[13] ABELIUK (1971), p. 23.

[14] ABELIUK (1971), p. 22.

The main peculiarity of the heads of agreement is that not all the obligations contained therein are binding to the parties.[15] They normally include obligations that are binding to the parties and other obligations that are not.[16] This feature constitutes an exception to the general structure of agreements.[17] The determination of which of the obligations of the heads of agreement are to be binding and the intention to be bound of the parties are matters of considerable debate.[18]

Accordingly, there are different kinds of preliminary agreements in terms of their bindingness.[19] They can go from mere term sheets to plan the negotiations to those that set almost all the negotiable conditions like the price or the date of execution of the definitive agreement.[20] In this regard, and following the relevant jurisprudence, some authors distinguish between two different types of preliminary agreements.[21] Type 1 refers to those preliminary agreements where parties agree on all the relevant conditions of the business, but there still are pending the determination of minimum specific details.[22] On the other hand, there are the Type 2 agreements where not all the conditions have been agreed yet, but parties express their will to keep negotiating under certain conditions.[23] The consequences of each of these types and their validity will depend on the jurisdiction where they are executed.[24]

As mentioned above, many sectors of the economy use heads of agreement in their commercial relationships.[25] The question, then, is what are they used for.

2.2 What are Heads of Agreement Used for?

Heads of agreement are useful to deal with open issues in a negotiation process,[26] stating stages to negotiate or giving a schedule to negotiations.[27] In complex transactions, parties may require time to analyse carefully the conditions for the transaction, or to conduct a due diligence process in order to assess the target of the transaction properly.[28] In this regard, heads

[15] GOSFIELD (2004), p. 55.

[16] TESTANI & LENTZ (2011), p. 12.

[17] GOSFIELD (2004), p. 55.

[18] See MCLAUCHLAN (2002), pp. 521–530.

[19] GOSFIELD (2004), p. 55.

[20] GOSFIELD (2004), p. 55.

[21] FOREMAN (2014), p. 18.

[22] FOREMAN (2014), p. 18.

[23] FOREMAN (2014), p. 19.

[24] FOREMAN (2014), p. 19.

[25] HOMBURGER & SCHUELLER (2002), p. 512.

[26] FOREMAN (2014), p. 15.

[27] HOMBURGER & SCHUELLER (2002), p. 511.

[28] HOMBURGER & SCHUELLER (2002), p. 511.

of agreement offer to the parties the chance to regulate, for instance, how to conduct the due diligence process, or to discuss the criteria to set a price.

Also, heads of agreement can provide a platform and set the agreed terms in order to avoid future misunderstandings.[29] By doing this, parties can enter into a formal and legal relationship without settling all the details of the commercial relationship and have the confidence that certain points will not be reopened to be discussed again.[30]

From another perspective, heads of agreement can also indicate the level of commitment of a party in relation to the relevant transaction.[31] Actually, heads of agreement can be classified according to this criterion.[32] Parties in complex transactions spend time and resources assessing the different aspects of the transaction, such as legal, financial, commercial. In this regard, parties feel more confident spending their resources when the counterpart is also committed to the transaction.[33] For example, one of the parties might expect exclusivity from the other during the negotiation period to know that the investment during this phase is taken seriously by the other party.[34]

So, as a general statement, heads of agreement are a mechanism to manage the risks involved in early negotiations, and to protect the parties' interests during these negotiation stages,[35] and particularly when things go wrong in the negotiations.[36] The question that naturally arises, then, is what are those risks. The answer is to be found in the main content of the heads of agreement.

2.3 What is the Main Content of the Heads of agreement?

Since different sectors of the economy use heads of agreement,[37] there might be matters that only apply for a specific sector. Still, it is possible to identify some standards or regular matters that appear in most heads of agreement.[38] Each of these matters could be topic for long discussions, but this article will only discuss in detail the most common matters of heads of agreement.[39]

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[29] FOREMAN (2014), p. 15.

[30] HOMBURGER & SCHUELLER (2002), p. 511.

[31] FOREMAN (2014), p. 15.

[32] GOSFIELD (2003), p. 106.

[33] HOMBURGER & SCHUELLER (2002), p. 511.

[34] FOREMAN (2014), p. 30.

[35] CREED (2010), p. 1254.

[36] See SCHOPF *et al.* (1996).

[37] HOMBURGER & SCHUELLER (2002), p. 512.

[38] GOSFIELD (2003), p. 145.

[39] See, generally, GOSFIELD (2003).

It is necessary to distinguish between those provisions that are generally considered as binding and those that are not. The provisions that are generally considered as binding to the parties are the intent of the parties, good faith in negotiations, exclusivity, limitations of responsibility of the parties, confidentiality and access to information, who will bear the expenses of the negotiations, events of default or early termination,[40] and —although not frequently mentioned— jurisdiction and applicable law.

Each of these topics reflects a risk that parties are dealing with.[41] For example, a potential buyer of a company might feel more confident in the transaction if he knows that he is the only potential buyer due to a clause of exclusivity.[42] In this case, the potential buyer will be more likely to invest time and resources in the transaction if the exclusivity is given or if parties agree to include a break-up fee, because the risk of parallel negotiations is controlled. Furthermore, keeping the transaction under confidentiality might be beneficial for both parties, avoiding the risks of third parties expectations, particularly in major transactions, and the release of sensitive information, among others.[43] These are some examples about how the heads of agreement manage the risks involved in transactions.

Regarding nonbinding provisions, they usually consist in matters that parties set in the preliminary agreement to follow up the negotiations and that will be fixed in the definitive agreement. For example, parties might have preliminary discussions on procedural adjustments due to the due diligence findings, or the duration of the due diligence process. These provisions have been considered nonbinding.

To summarise, heads of agreement are instruments used in the early stages of the commercial transactions that have the peculiarity that not all the provisions therein contained are binding on the parties. Parties use them to deal with the risks involved in the early stages of negotiations and to set a schedule or a plan for the negotiations. As it looks, the proliferation of the use of heads of agreement became evident. Chile did not want to stay behind in the use of these agreements and, consequently, started to use them extensively.

III. HEADS OF AGREEMENTS: PRELIMINARY NEGOTIATIONS OR CONTRACTS?

The legal nature of the heads of agreement in this discussion refers to the legal category that heads of agreement have within the Chilean context. Basically, the question is whether the heads of agreement are contracts in their own terms or a previous instrument that leads to a contract. Rephrasing the question using the legal concept, the question is whether heads of agreement have a contractual legal nature or they fall into the category of pre-contractual negotiations, and consequently their legal nature is extra-contractual.

The incorporation of these documents into the domestic jurisdiction is not innocuous and their validity and effects need to be clarified. The challenge that heads of agreement

[40] GOSFIELD (2003), p. 165.

[41] CREED (2010), p. 1254.

[42] GOSFIELD (2003), p. 153.

[43] GOSFIELD (2003), pp. 157–158.

present in the Chilean system is that the Chilean law does not provide specific regulation for them and, consequently, lawyers are walking on eggshells. Basically, a good legal advice in these complex transactions supposes the proper and deep understanding of the legal institutions surrounding them. Next parts of this article intend to be a contribution to provide such legal advice.

As a general statement, in the Chilean civil law the acts of any entity can have either a contractual or an extra-contractual nature,[44] although there might be overlap in the causes of actions that arise from them.[45] The main difference between them lies in the nature of the obligations, and the applicable legal regime for each of these categories.[46] Accordingly, heads of agreement can be either contractual or extra-contractual. Since the heads of agreement are present at the beginning of the negotiations and there is still no clarity regarding the existence of binding obligations at this stage, it is necessary to determine the relevant category into which they fall. As will be analysed, the legal consequences of these categories are rather different.

The importance of this question lies in the consequences of its answer. As will be discussed below, the validity, effects, and remedies that arise from the breach of heads of agreement are different based on the answer to the question whether they are contracts or not. To cite but one example, the items to be indemnified in case of a breach of a standard of behaviour that will arise from extra-contractual liabilities are different from those that arise from contractual obligations. To determine the legal status of heads of agreement in Chilean law it is necessary to solve the issue of the nature of heads of agreement.

Consequently, in what follows I will analyse these two options of understanding the heads of agreement in the Chilean context. As said, they can be either contractual obligations or extra-contractual standards of conduct.

3.1 Heads of Agreement as Preliminary Negotiations

Preliminary negotiations are the initial phases of the formation of the consent between parties that intend to enter into an agreement.[47] At this stage, the parties to a relationship have not agreed on the conditions by which they will be bound. They are exploring the conditions, but there is no definitive consent.

During the preliminary negotiations, parties are free to set the terms and conditions of their future stages on the negotiations.[48] This means, among other things, that parties can prepare the documents they consider necessary to achieve their goal. For instance, parties might be likely to set a schedule to discuss the conditions for the transactions.

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[44] RODRÍGUEZ GREZ (2009), p. 12. For the purposes of this article, extra-contractual and torts are synonyms and interchangeable terms.

[45] See CORRAL (2010).

[46] RODRÍGUEZ GREZ (2009), p. 21.

[47] BARROS (2006), p. 1001.

[48] CELEDÓN & SILBERMAN (2010), p. 18.

This sounds rather similar to the description of heads of agreement discussed above. In fact, there are some reasons to believe that heads of agreement are preliminary negotiations. As discussed, heads of agreement consist of instruments used in the early stages of commercial transactions, so they occur jointly with the preliminary negotiations. Also, the content of the heads of agreement can be, in some aspects, non-binding on parties, which is the general rule for the preliminary negotiations. Consequently, there are reasons to consider that heads of agreement are equivalent to preliminary negotiations in the Chilean context. It is not surprising that some authors do not make distinctions between these negotiations and heads of agreement.[49] Instead, they direct their attention to distinguish negotiations from an irrevocable offer, because the latter has a specific regulation. This explains why it is possible to understand heads of agreement as preliminary negotiations.

The Chilean legislation does not provide any specific regulation for these negotiations. The consequence of this is that authors and courts must draw from the existing framework in order to affirm the existence of obligations during this period.[50] The traditional construction of duties during this period is based on the good faith principle, as a duty to negotiate in good faith. In addition, these duties can be related to the tension between freedom and reliance that characterises the relation between the parties in a negotiation process.

The good faith principle has been consistently recognised in the Chilean system.[51] Courts have used it as a general principle of law.[52] The idea of a general principle of law in the Chilean context means that it not only applies to a certain or specific branch of law but also it inspires and it is spread in the complete legal system, even if the law does not expressly indicate so. In a recent case, the Chilean Supreme Court affirmed once again that the good faith principle applies not only in contractual relations but also in all branches of the law, reaffirming an established position.[53] In addition, there also are cases where the good faith principle has been directly applied to the pre-contractual stage.[54] This means that there is no doubt that this principle applies to pre-contractual relations.

The legal source of application of the good faith principle is to be found in the *Chilean Civil Code*.[55] Section 1546 of the *Chilean Civil Code* states that contracts must be performed in good faith. Good faith requires parties to meet obligations expressly indicated in the contract, and also all things that, according to the nature of the obligation, the law, or custom, belongs to the nature of the obligations assumed by the parties in the contract.[56] Although this section only mentions contracts, the Chilean Supreme Court have indicated that this section is to be

[49] DE LA MAZA (2006), p. 132.

[50] BARROS (2006), p. 1004.

[51] See, eg., GUZMÁN BRITO (2002); EYZAGUIRRE & RODRÍGUEZ (2013); IRURETA (2011).

[52] See, eg., *Cominor Ingeniería y Proyectos S.A. con SQM* (2014).

[53] *Cominor Ingeniería y Proyectos S.A. con SQM* (2014), c. 14º.

[54] See, eg., *Territoria S.A. con Inmobiliaria Laja Ltda.* (2012).

[55] Civil Code, S. 1546.

[56] Civil Code, S. 1546.

understood as a general principle of the Chilean law and, therefore, it applies to all legal situations.[57]

Based on the above, authors have indicated that during the negotiations phase parties owe certain duties to each other that arise from the good faith principle.[58] In general terms, these duties can refer to the obligation to negotiate in good faith, to share information, be loyal to each other, among others. The language and the particular obligations that arise from them are not clear since they are open standards. This implies that the specific content of these duties cannot be set *ex ante* and depends on the facts of the specific case. Nevertheless, what this principle means is that although there are no contractual relations during the negotiation process, parties are not entirely free to do what they want. On the contrary, parties have to behave according to these abstract standards, in spite of the fact that the determination of their breach can only be determined *ex post*.

The legal consequence of the existence of a duty is that its breach leads to the liability of the offender. Accordingly, authors have created the figure of pre-contractual liability, which refers to all damage suffered during the process of consent formation.[59] The principle here is that if a party in a negotiation breaches the duties that arise from the pre-contractual standards of conduct based on the good faith principle, he has to respond for all the damages caused. Of course, this does not mean that a party that is negotiating a transaction is obliged to enter into a final agreement.[60] On the contrary, the general rule is that the early conclusion of negotiations does not imply a breach of any duty.[61] There is a special concern in order to avoid the excessive limitation of the freedom to negotiate without the obligation to reach an agreement.[62] The only obligation that parties would have at this stage is to conduct the negotiations in good faith. As said, since these duties are general and abstract standards of conduct, they cannot be specified *ex ante*, and to know if there is a breach of them courts will need to review them on a case-by-case basis.[63]

The legal nature of the duties found in the pre-contractual stage is extra-contractual.[64] This issue has generated some debate between the authors.[65] However, nowadays most authors in the Chilean context do not doubt the conclusion that the nature of the duties or the applicable regime to the preliminary negotiations is extra-contractual.[66] Also, authors consider

[57] *Jimenez con Armijo* (2011), c. 4º.

[58] BARROS (2006), p. 1001.

[59] ROSENDE (1979).

[60] BARROS (2006), p. 1005.

[61] BARROS (2006), p. 1008.

[62] CELEDÓN & SILBERMAN (2010), p. 117.

[63] BARROS (2006), p. 1001. It would be very interesting to analyse what the courts have said regarding these standards to see if there are specific trends. However, this would be out of the scope of this article.

[64] ROSENDE (1979), p. 60.

[65] CELEDÓN & SILBERMAN (2010), p. 78.

[66] See, eg., ROSENDE (1979); CELEDÓN & SILBERMAN (2010); BARROS (2006).

that during this stage parties have not reached an agreement yet, and subsequently, there is no intention to be bound in terms of contractual obligations.[67] The main reason to support this position is that the pre-contractual liability purpose is not to protect the interests of a creditor but to safeguard general interests, such as freedom of contracting.[68] The Chilean Supreme Court also has reached the same conclusion.[69]

One of the critical points here, then, is that if heads of agreement are understood as preliminary negotiations, the content of them is not binding on the parties, and parties can review and reopen points in the negotiations as if they never were agreed, provided that they respect the standards of behaviour that arise from the good faith principle.[70] This is because extra-contractual standards of conduct do not provide specific obligations of performance *ex ante*.[71] Thus, heads of agreement would not oblige parties to accomplish certain agreed obligations but to observe a certain standard of behaviour. Also, the applicable legal regime for the breach of these standards of behaviour would be torts.

To summarise, preliminary negotiations are essentially extra-contractual duties of care that parties owe to each other due to the particular situation of negotiating the terms of a contractual relationship based on the general principle of good faith.[72] There is some similarity between preliminary negotiations and heads of agreement. If heads of agreement were considered as preliminary negotiations, their legal nature would be extra-contractual and their content would not be binding on the parties, carrying with that all the consequences that imply and this article will discuss below. Prior to discussing these consequences, it is important to analyse the other possible understanding of the heads of agreement that makes them more similar to a contract, and consequently, makes them fall into the category of contractual obligations.

3.2 Heads of Agreement as Contracts

In the Chilean context, the second approach that is possible regarding heads of agreement is to understand them as contracts. The Chilean Civil Code provides a definition of contract.[73] According to this definition, a contract or convention is an act by which one party assumes the obligation with respect to another to give, to perform or not to perform something.[74] Authors have criticised this definition saying that it treats as equivalent conventions

[67] CELEDÓN & SILBERMAN (2010), p. 78.

[68] CELEDÓN & SILBERMAN (2010), p. 83.

[69] See, eg., *Jimenez con Armijo* (2011).

[70] RISUEÑO (2010), p. 452.

[71] BARROS (2006), p. 1001.

[72] BARROS (2006), p. 1004.

[73] Civil Code, S. 1438.

[74] Civil Code, S. 1438.

and contracts, when technically speaking a contract is a specific type of convention.[75] Assuming the distinction made by the authors, a convention is an agreement of two or more parties that intends to produce legal effects in general, while a contract is an agreement with the specific purpose of creating obligations on the parties that enter into it.[76] Consequently, when one says that a heads of agreement is a contract is saying that the main intention of it is to create an obligation on the parties that are entering into it.

Beyond the name, there are many reasons to understand heads of agreement as contracts. First, this article has explained that heads of agreement are instruments that parties in a commercial transaction use expecting that they would imply a higher level of commitment of the other party.[77] This expectation would have no sense if heads of agreement were not, at least to some extent, binding on the parties. Also, heads of agreement are instruments that may contain the intention of the parties regarding certain matters and they, definitively, are expecting to be bound by such terms.[78] Take for example a confidentiality clause that parties agreed in a preliminary agreement to facilitate a due diligence process prior to the possible acquisition of a company. By this clause, the potential vendor is trying to protect the information of its company and to restrain the use of such information. Provided that the contract itself is valid, this vendor is certainly expecting that this clause is enforceable, which means that it is binding on the parties. Otherwise, the potential vendor would never have the confidence to provide sensitive information to a third party. Far less in a context where there is no specific clarity of the standards of behaviour required for preliminary negotiations. Consequently, parties may face the heads of agreement as if they were assuming obligations in a contractual meaning. At this point, this article is not defending this position but just indicating that there are reasons to understand heads of agreement as contracts.

If heads of agreement were contracts, in the Chilean context it is necessary to distinguish between two possibilities. First, there is the promise agreement, which is a regulated agreement. The other possibility is that heads of agreement falls into the general category of innominate or non-regulated agreements. Both present different features and effects, so it is necessary to make such differences clear.

3.2.1 The Promise Agreement

The promise agreement is a regulated contract.[79] A regulated contract in the Chilean context means that the conditions to enter into this agreement are stated in the law.[80] It is regulated in Section 1554 of the *Chilean Civil Code*.[81] This section applies to all promise

[75] MEZA BARROS (2007), p. 9.

[76] MEZA BARROS (2007), p. 9.

[77] FOREMAN (2014), p. 15.

[78] See, eg., GOSFIELD (2003).

[79] See Civil Code, S. 1554.

[80] BARCIA LEHMANN (2010), p. 29.

[81] Civil Code, S. 1554.

agreements, no matter the specific content of the promise. In other words, this regulation is of general application.[82] The promise agreement consists of a contract that is entered into by parties in which they assume the obligation to enter into another definitive agreement.[83]

The promise agreement has certain formal requirements to be legally binding.[84] In fact, Section 1554 of the *Chilean Civil Code* states that the promise to enter into an agreement does not produce any effect, unless it is entered into fulfilling the requirements indicated therein.[85] These requirements are that the promise has to be written,[86] that the promised agreement shall not be invalid or null,[87] that the promise agreement mentions the term or condition to enter into the definitive agreement,[88] and that the promise agreement shall contain all of the terms and conditions of the promised agreement, so the only steps left are the legal formalities required to enter into the definitive agreement.[89]

Maybe the most important of these requirements for the purposes of this article is the last. This requirement obliges the parties to set all the conditions of the definitive agreement in the promise agreement, which, as seen above, is not necessarily the general rule regarding heads of agreement. As a matter of practice, when parties are entering into a promise agreement, they generally attach a version of the definitive agreement to it as an annex. This practice responds to the requirement abovementioned.

The requirement of setting all the conditions of the definitive agreement in the promise agreement gives the latter a similar structure to the heads of agreement Type 1. As indicated above, Type 1 refers to those preliminary agreements where parties agree in all the relevant conditions of the business, but there are still pending the accomplishment of specific details.[90]

The use of promise agreements is widespread in some Chilean industries. For instance, it is very common to entering into a promise agreement prior to acquiring real estates. The reason of the use of this type of agreement in this industry responds to the features of this particular industry. For example, the potential buyer normally has to obtain the financing for the operation. So, although the parties have all the conditions set, the financing approval appears as a condition to the execution of the definitive agreement. This is a quite simple example of the use of the promise agreement. The resources industry, though, is rather more complex. Consequently, it is harder to find promises agreements as a general practice, although you might find preliminary agreements in general.

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[82] ALESSANDRI (2003), p. 839.

[83] ALESSANDRI (2003), p. 841.

[84] ALESSANDRI (2003), p. 841.

[85] Civil Code, S. 1554.

[86] Civil Code, S. 1554.

[87] Civil Code, S. 1554.

[88] Civil Code, S. 1554.

[89] Civil Code, S. 1554.

[90] FOREMAN (2014), p. 18.

3.2.2 Heads of Agreement as Innominate Agreements

Chilean private law is widely inspired by French private law.[91] The *Code Napoleon* is the base of the *Chilean Civil Code*.[92] In fact, the *Code Napoleon* is the legal background for many of the private law codifications present in Latin America.[93] Understandably, many of the principles that inspired the *Code Napoleon* were reproduced in the Latin American countries. This inspiration extends from the idea of codification itself to the form in which law professors teach private law in the Latin American universities.[94] In this regard, contract law is not an exception.[95]

One of these principles —and maybe the cornerstone of the Chilean private law— is the principle of will's autonomy.[96] Philosophically speaking, this principle is twofold. First, according to this principle, no man can be obliged to something that has not previously consented.[97] On the other hand, the obligations that a man has freely accepted should have effects.[98] Economically speaking, the principle of autonomy is the most important expression of economic liberalism and allows the free circulation of goods.[99] Beyond the interesting discussion regarding the justifications for the principle of autonomy,[100] the point to be made here is that contract law in Chile is subject to this principle.[101]

The principle of autonomy takes, in the specific field of contract law, the form of two different principles.[102] First, there is the principle of contractual freedom.[103] According to this principle, parties in a transaction are free to set and agree on the terms of their relations, provided that it does not contravene public morality or public order.[104] Consequently, parties can freely agree on the terms that they consider proper, provided that these terms do not contravene public order. Second, there is the principle of consensualism.[105] According to this

[91] DOMÍNGUEZ ÁGUILA (2005), p. 62.

[92] MIROW (2000), p. 85.

[93] See GUZMÁN BRITO (2005).

[94] See DOMÍNGUEZ ÁGUILA (2005).

[95] SEGURA RIVEIRO (2005), p. 24.

[96] SEGURA RIVEIRO (2005), p. 24.

[97] FIGUEROA (2011), p. 53.

[98] FIGUEROA (2011), p. 53.

[99] FIGUEROA (2011), p. 55.

[100] See WEINRIB (2013), p. 343.

[101] FIGUEROA (2011), p. 55.

[102] FIGUEROA (2011), p. 56.

[103] FIGUEROA (2011), p. 56.

[104] See LÓPEZ SANTA MARÍA (1998), pp. 46–51.

[105] LÓPEZ SANTA MARÍA (1998), pp. 50.

principle, the contract comes into existence when the offer and acceptance converge.[106] This principle is the general rule in the Chilean Civil Code, although there are specific exceptions where in addition to the convergence of the acceptance and the offer are required some formalities like registration.[107]

From both of these principles arise many legal problems such as what public order means, when the acceptance should be considered as free, and so on. Nevertheless, the analysis of these problems is far beyond the scope of this article. What needs to be noticed, though, is that according to these principles, parties in a relation can freely agree what they consider pertinent, and as a general rule the mere convergence of their intention is enough to conclude agreements.

Due to the above, preliminary agreements can fall into the category of non-regulated or innominate agreements, as opposed, for instance, to the promise agreement, which is a regulated agreement.[108] As said, based on the autonomy principle, the Chilean Civil Code allows the parties in a commercial transaction to enter into agreements that are not expressly regulated, unless they are null or void under the legislation.[109] So if the parties want to regulate matters during the preliminary phases of a commercial transaction, the only limits they have are the limits set for all agreements, such as legal capacity, and public order. The key issue to understand heads of agreement as innominate agreements, then, is the consent formation among the parties in the commercial transaction.

If heads of agreement were considered contracts, whether they were promise agreements or innominate agreements, the legal nature of the obligations contained therein is contractual as opposed to extra-contractual or tort liabilities. The difference between contractual and tort or extra-contractual obligations are quite important within the system. Consequently, now it is necessary to analyse the significances of this. The next Part IV will provide a detailed analysis of the consequences of assuming the heads of agreement as contractual obligations or as preliminary negotiations.

3.3 Is There a Legal Nature of Heads of Agreement in the Chilean Legal System?

3.3.1 The Problem of the Categorisation

As previously analysed, the main feature of the heads of agreement is that they contain both binding and non-binding obligations, and the parties to an agreement can set the terms and conditions of a particular preliminary agreement freely.[110] Also, the language of the heads of agreement varies in each particular situation, so it is not possible to indicate *ex ante* the legal nature of a particular heads of agreement. However, what indeed can be identified is the

[106] LÓPEZ SANTA MARÍA (1998), pp. 50.

[107] See the Chilean Civil Code. For example, real estates require registration.

[108] LÓPEZ SANTA MARÍA (1998), p. 97.

[109] BARCIA LEHMANN (2006), p. 163.

[110] GOSFIELD (2003), p. 55.

element that makes the difference between heads of agreement as contractual obligations or heads of agreement as duties of care under extra-contractual law. This is the consent. If there is consent, parties have entered into an agreement. If there is not, then they are in the tort field. The question that now needs an answer then is when the consent is formed in the Chilean Law.

3.3.2 Consent in Chilean Law

The consent or agreement does not need to be regarding a complete transaction. It is possible to create specific obligations to set the conditions to enter a commercial relation. For instance, it is not necessary to have an agreement over all the terms of a purchase. Instead, the consent may be regarding specific obligations, such as exclusivity and confidentiality. As will be seen, what matters the most is the convergence of the offer and the acceptance. This is because the consent or agreement under the Chilean law consists of two different legal acts: the offer and the acceptance.[111] Only when the offer and acceptance converge, the contractual obligations are created and have legal existence.[112] This construction is common in both civil law and common law jurisdictions.[113] Of course, this statement does not say too much, so it requires a further analysis of the each of both elements.

1. The Offer

Historically, Chilean legislation has not provided a conceptual definition for the concept of offer.[114] The Chilean Supreme Court, however, has said that the offer is the expression of willingness in order to give, perform or not to perform something.[115] In addition, authors agree in a definition of the offer saying that the offer is the unilateral act by which one party proposes to another the conclusion of an agreement in such a way that, if the other party accepts without conditions, the consent is formed, and parties have entered into an agreement.[116]

Due to increased interest in the matter, now Chilean legislation provides three different regimes that regulate the offer.[117] First, there is the *Commercial Code*, which regulates the requirements for the offer in commercial acts,[118] then the offer for consumer law purposes,[119]

[111] SEGURA RIVEIRO (2005), p. 26.

[112] SEGURA RIVEIRO (2005), p. 26.

[113] See, eg., PATTERSON *et al.* (2012), p. 53.

[114] VARAS & MOMBERG (2006), p. 63.

[115] See *Martinez y otro con Coexpan Chile S.A.* (2005).

[116] PESCIO (1978), p. 50; VARAS & MOMBERG (2006), p. 62.

[117] VARAS & MOMBERG (2006), p. 62.

[118] Commerce Code, S. 97-105.

[119] Law No 19,946.

and finally the offer for purchase of international goods.[120] For the purposes of this article, the relevant regulatory framework is the one provided by the Commercial Code, although some of the requirements apply to all these frameworks.[121]

The offer has to comply with certain requirements to be valid.[122] In addition, there are many categories to analyse the offer in terms of the means to do so.[123] Besides the means of the manifestation of an offer, the crucial factor is to identify the necessary elements to have a valid offer under the Chilean system.

(i) The Intention to be Bound

When a party is offering to enter into a commercial transaction, its manifestation needs to be serious and under the understanding that, if the other party accepts the offer, the former will be bound by what he or she offered.[124] Authors have indicated that there are two requirements to recognise an offer made with the intention to be bound.[125] First, there must be an intention of the party to be bound by the exact terms of the offer.[126] Second, the intention to be bound must be indicated in the offer.[127] The latter does not mean that the offer needs to say literally that the party wants to be bound.[128] It is necessary that the situation allow concluding the intention to be bound.[129] Other authors have identified the intention to be bound with the intention to seek an end recognised by the law.[130]

Case law has not added too much to this requirement. There is only one idea that originated in the Chilean courts which is worth highlighting. The Appeal Court of Santiago has indicated that the manifestation of willingness is not necessarily linked to any specific sacramental formula. Any expression of it is enough for the creation of the agreement.[131] This idea is in connection with the above in terms that what is relevant the most is that from the context can be deducted the intention to be bound. No matter whether there is a specific formula to express such intention or not.

(ii) Precision or Completeness of the Offer

[120] United Nations Convention on Contract for the International Sale of Goods 1980.

[121] VARAS & MOMBERG (2006), p. 66.

[122] VARAS & MOMBERG (2006), p. 64.

[123] VIAL DEL RÍO (2007), p. 65.

[124] VIAL DEL RÍO (2007), p. 64.

[125] VARAS & MOMBERG (2006), pp. 65–66.

[126] VARAS & MOMBERG (2006), p. 66.

[127] VARAS & MOMBERG (2006), p. 65.

[128] VARAS & MOMBERG (2006), p. 65.

[129] VARAS & MOMBERG (2006), p. 65.

[130] VIAL DEL RÍO (2007), p. 47.

[131] DÍAZ (2014), p. 17.

The offer has to be complete or at least indicate all the essential requirements of the proposed agreement.[132] This requirement sounds clear but when applied to concrete cases it shows many difficulties.[133] Also, in the fields of consumer law it has generated many practical difficulties.[134] The determination of the precision of the offer and its completeness is a matter of fact and needs to be analysed on a case-by-case basis.[135] However, there is this principle that states that if the contract is regulated it has to contain all the essential elements indicated by the law and, if it is a non-regulated contract, then it has to have all the elements that allow to the acceptant to accept in a simple manner.[136] Of course, this principle is still subject to the same practical problems, but at least it gives a more or less clear idea of what to expect.

(iii) Offer to a Determined Person

The third requirement of the offer in the Chilean system is that it has to be to a determined person.[137] This requirement raises many discussions in consumer law.[138] However, in the context of complex commercial transactions that use the heads of agreement is less probable to have offers to undetermined persons that may raise issues with regard to this requirement.

To summarise, the offer is a unilateral act that requires to be made with the intention to be bound, in complete terms, and to a determined person. In addition to these requirements, there are the general requirements for every act that attempt to have legal effects within the Chilean legal system. This means that the person that makes the act has to have the legal capacity to do so, and that the willingness is not affected by a nullity cause stated in the law. Also, to create an agreement the offer has to be available for acceptance or in force at the moment of the acceptance.[139]

2. The Acceptance

The acceptance is the act by means the recipient of the offer expresses its conformity with the terms of the offer.[140] If the acceptance meets its legal requirements, then there is a meeting of the minds and, consequently, an agreement.[141] These legal requirements are the following.

[132] SANDOVAL (1992), p. 10.

[133] SEGURA RIVEIRO (2005), p. 42.

[134] SEGURA RIVEIRO (2005), p. 43.

[135] SEGURA RIVEIRO (2005), p. 42.

[136] SEGURA RIVEIRO (2005), p. 43.

[137] SANDOVAL (1992), p. 11.

[138] SANDOVAL (1992), p. 11.

[139] SANDOVAL (1992), pp. 11–12.

[140] SEGURA RIVEIRO (2005), p. 50.

[141] SANDOVAL (1992), p. 15.

(i) Correspondence between the Offer and the Acceptance

The acceptance cannot modify any part of the offer.[142] According to this requirement, the offer and the acceptance have to converge in the same terms.[143] This is a traditional view that has generated many problems in modern commercial transactions.[144] In fact, it has been overcome by the modern practice.

(ii) The Acceptance Must be Communicated Promptly

Two elements should be noticed regarding this requirement. First, the acceptance must be communicated, the method does not matter.[145] In this regard, the acceptance can be explicit or inferred from conduct.[146] In some circumstances, a specific method of acceptance could be required.[147] Also, in some qualified circumstances the silence can constitute a method of acceptance.[148] Second, the acceptance must be prompt.[149] This means that the acceptance has to be communicated while the offer is in force.[150]

There are many other rules that regulate some specific issues like the acceptance sent by post, or others that are out of the scope of this article. What should be noticed here is that only when a valid offer converges with a valid acceptance the consent is formed and, consequently, it is possible to identify a contract with all the consequences analysed above. Accordingly, heads of agreement are only contracts when from the particular circumstances the judge can infer or construe the existence of a valid offer and its valid correlative acceptance. Next section will briefly discuss some practical ideas regarding the status of heads of agreement within the Chilean legal system.

3. Consent and Heads of Agreement

As has been discussed, the element that distinguishes between heads of agreement as contracts and heads of agreement as preliminary negotiations is the consent. Since the specific content of heads of agreement is a matter of fact the conclusion cannot be just one, it will depend on the specific case. However, what judges and all the relevant actors must bear in mind is that the element that will make the distinction is the consent.

For instance, if a written heads of agreement only contains a schedule for negotiations it is more likely to be categorised as a preliminary negotiation. In this case, the consent does

[142] SANDOVAL (1992), p. 16.

[143] SEGURA RIVEIRO (2005), p. 51.

[144] SEGURA RIVEIRO (2005), p. 51.

[145] BARCIA LEHMANN (2006), p. 46.

[146] BARCIA LEHMANN (2006), p. 46.

[147] BARCIA LEHMANN (2006), p. 46.

[148] See, eg., STITCHKIN (1975), p. 128; Civil Code, S. 2125.

[149] BARCIA LEHMANN (2006), p. 46.

[150] Commerce Code, S. 102.

not form and specific obligations are not assumed. Thus, parties would only owe to each other a standard of conduct based on the good faith principle. On the contrary, if, for instance, a memorandum of understanding contains specific obligations like confidentiality, exclusivity, and parties agreed validly to them, those obligations are enforceable. More complex would be the case of the promise agreement, where the obligation is to enter into the definitive agreement. However, due to the strict requirements of the promise agreement is not very likely to see a party assuming obligations without the consciousness of doing it.

Lawyers must identify the interests of their clients in order to follow a strategy according to those interests. For instance, if a client is only approaching a possible business without clear intentions of entering into a formal agreement, the role of the legal advisor is to avoid instruments or behaviours that could be interpreted as offers or acceptances. Conversely, if there is a serious intention of being bound —or binding the other party— in a commercial relation, lawyers should approach making clear offers or acceptances. They should always, though, have in mind the consequences of each of the paths.

IV. WHY IT MATTERS: THE DIFFERENCES BETWEEN HEADS OF AGREEMENT AS TORTS AND AS CONTRACTS IN CHILE

There are many differences between the regime applicable to preliminary negotiations —which is the extra-contractual or torts regime— and the regime applicable to contracts. Some of these differences are more important than others for the purpose of this article.[151] Assuming that, this part will focus on the most important differences between understanding the heads of agreement as contracts or as extra-contractual standards of behaviour.

4.1 Negligence

While in the Chilean contract law negligence admits different categories, in torts negligence is one and only one category.[152] At this point, we are only referring to negligence and explicitly excluding the discussion about the intentional breaches or wrongful misconduct.[153] Negligence is part of the subjective attribution of responsibility. It applies to both contractual and torts actions.[154]

In torts, negligence means the lack of due diligence in performing an action.[155] This kind of negligence does not admit different categories, and its analysis must be in abstract.[156]

[151] For a complete analysis see, generally, BARROS (2006), pp. 978–1071.

[152] BARROS (2006), p. 976.

[153] RODRÍGUEZ GREZ (1999), p. 142.

[154] CORRAL (2003), p. 207.

[155] ABELIUK (2008), p. 821.

[156] CORRAL (2003), p. 213.

The latter means that judges should appreciate the lack of due diligence according to general standards of conducts instead of the appreciation of the particular situation of the offender.[157] The standard required by torts is the *good pater familias*.

Unlike torts, contractual negligence admits three different categories of negligence.[158] Section 44 of the Chilean Civil Code provides this categorisation.[159] First, there is gross negligence. Gross negligence, according to the cited provision, means not to manage the third party business with the duty of care that even negligent persons tend to have with their own businesses.[160] This negligence standard is the minimum recognised in contractual relations, so it is assimilated to wrongful misconduct.[161] Second, there is slight negligence, which is defined as the standard of care that people generally use in their own business.[162] This is the general rule for the majority of the legal systems.[163] Finally, there is very slight negligence, which the Chilean Civil Code defines as the duty of care that a thoughtful man would employ in his own meaningful businesses.[164]

The relevance of the distinction included in contractual negligence is that different contracts will imply different requirements of care.[165] Chilean Civil Code states that if a contract is only beneficial to the creditor, then the debtor only has to respond for gross negligence.[166] For example, in a donation that only benefits one party, the donor will only respond for gross negligence. In turn, if a contract is beneficial for both parties, then the applicable standard is slight negligence.[167] Finally, if the contract only benefits the debtor, the debtor is responsible for very slight negligence.[168]

Consequently, if heads of agreement were considered preliminary negotiations, the standard of conduct required is only one. The analysis would be in terms of whether the actions of the offender breach a general standard of care expected from every reasonable person in his or her situation. On the contrary, if heads of agreement were considered contracts, then judges will need to review the obligations assumed in the contract and to analyse if it is an agreement that benefits the creditor, both parties, or the debtor, to determine whether the party that fails to comply with the obligation was obliged to do so according to the specific standard

[157] CORRAL (2003), p. 214.

[158] ABELIUK (2008), p. 907.

[159] Civil Code, S. 44.

[160] Civil Code, S. 44.

[161] ABELIUK (2008), p. 823.

[162] ABELIUK (2008), p. 823.

[163] ABELIUK (2008), p. 823.

[164] Civil Code, S. 44.

[165] ABELIUK (2008), p. 824.

[166] Civil Code, S. 1547.

[167] Civil Code, S. 1547.

[168] Civil Code, S. 1547.

required for the particular agreement. In the latter case, practice suggests that the general rule is that heads of agreement are beneficial for both parties, so the standard generally applied would be the slight negligence. However, it is not hard to imagine situations where only one party may benefit from a preliminary contract. For instance, if the heads of agreement only contains an obligation of confidentiality for one party, then the standard required may change. The specific standard will vary according to each particular heads of agreement. These distinctions have been widely applied by the Chilean Supreme Court.[169]

4.2 The Proof of Negligence

As a general rule, in Chilean contract law the breach of an agreement is presumed as negligent, while in torts the claimant has to prove it.[170] In fact, regarding the contracts, section 1698 of the Chilean Civil Code states that the burden of proof of the existence of the obligation lies with the claimant.[171] Once the claimant has proved the existence of the obligation, the negligence is presumed.[172] Consequently, the defendant is the one who has to prove that he acted with the diligence required for the specific obligation or that there were reasons such as *force majeure* that release him to comply with such obligation.[173] The Chilean Supreme Court has recognised this construction.[174] Also, scholars have reached the same conclusion.[175]

On the other hand, the injured party in torts has to prove that the other party breached the standard of conduct required by law.[176] This means that the burden of proof lies with the claimant.[177] So this case is just the opposite of contract law.[178]

Regarding heads of agreement the difference is clear. If heads of agreement were preliminary negotiations, and consequently the applicable regime would be extra-contractual, the affected party by an alleged breach would bear the burden of proof of negligence.[179] On the contrary, if heads of agreement were contracts, the negligence would be presumed, and the claimant needs only to focus on the proof of the existence of the obligation allegedly breached.

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[169] See *Arce con Silva* (1953). This case is considered as essential to understand how courts use the different categories of negligence.

[170] BARROS (2006), p. 976.

[171] *Civil Code*, S. 1689.

[172] BARROS (2006), p. 982.

[173] *Civil Code*, S. 1547 and 1689.

[174] See, eg., *Vidal Heuisler y otros con Hospital Clínico de la Pontificia Universidad Católica de Chile* (2015), C. 15.

[175] ABELIUK (2008), p. 826.

[176] ABELIUK (2008), p. 826.

[177] ABELIUK (2008), p. 826.

[178] ABELIUK (2008), p. 217.

[179] ABELIUK (2008), p. 217.

4.3 Statutory Limitations of Actions

There are differences between torts and contractual liabilities in terms of commencing actions in court.[180] Section 2515 of the Chilean Civil Code sets out a limitation period for the commencement of actions derived from contracts, as a general rule.[181] According to this, the limitation period for the legal actions that arise from a breach of a contract is five years from the date when the obligation becomes due.[182] There are some exceptions to this rule but they are not relevant for the heads of agreement context.[183]

The above-indicated period does not apply to torts causes of actions.[184] In fact, in torts, although there also are some exceptions, the general rule for the limitation period is four years from the performance of the fact that gave rise the cause of action.[185] Both contractual and torts limitation periods are set out by the law and parties cannot agree to extend them.[186]

The consequences of the statutory limitations in Chile are a matter of considerable debate.[187] Authors have debated whether it is the right to commence a legal proceeding or the obligation itself that is precluded by the limitation.[188] Besides this interesting doctrinal debate, there is a crucial practical consequence of the expiration of a limitation period. This consequence is that it creates a defence for the defendant against any claim based on the action allegedly committed or right supposedly affected.

Between the fourth and fifth year it becomes critical. During this period, only the contractual cause of action is still possible, without creating a defence to the defendant. When parties are making significant investments in the preliminary stages of a project, they may be willing to preserve the causes of actions for as long as possible. If heads of agreement were considered contracts, the limitation period lasts one additional year compared to the general limitation period of torts causes of actions. This year can make the whole difference in the success of a legal action.

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[180] BARROS (2006), p. 979.

[181] Civil Code, S. 2515.

[182] Civil Code, S. 2515.

[183] For a complete analysis of the statutory limitations in Chile, see, generally, DOMÍNGUEZ ÁGUILA (2004).

[184] BARCIA LEHMANN (2010b), p. 244.

[185] Civil Code, S. 2332.

[186] DOMÍNGUEZ ÁGUILA (2004), p. 41; See also BARCIA LEHMANNN (2012), p. 146.

[187] DOMÍNGUEZ ÁGUILA (2004), p. 47.

[188] DOMÍNGUEZ ÁGUILA (2004), p. 48.

4.4 The Structure of Causes of Actions

The causes of actions are different for contracts and torts in case of breaches of contractual obligations or standards of behaviour, respectively.[189] Contracts, in civil law systems, create obligations to give something, to perform an action or to not perform a specific action.[190] Consequently, in cases of breaches of contracts the plaintiff is able to seek, in addition to compensation for the damage caused, the compulsory performance of the breached obligations.[191] Since this is not the general rule in common law systems,[192] this idea requires further explanations.

Section 1460 of the Chilean Civil Code distinguishes between three different types of obligations.[193] First, there are the obligations to give something, which may mean the obligation to transfer the property or any other *real right,* or to give the tenancy over an object.[194] Second, there are the obligations to perform something, in which a person or legal entity assumes the obligation to execute a certain action,[195] for instance, rendering a service or an art piece. Third, there are the obligations to not perform a specific action. The purpose of this third type of obligation is the abstention to perform an action that otherwise would be permitted.[196] This is consistent with Section 1438 of the *Chilean Civil Code,* that sets forth that there are three types of obligations: obligations to give, to perform or to avoid certain action or result.

These three categories have an important difference regarding the remedies that the plaintiff can claim in a case of breach.[197] In obligations to perform, the plaintiff is able to choose between the payment of compensation or the specific performance of the relevant obligation.[198] Likewise, in obligations to not perform an action, the plaintiff can choose whether to seek the compensation or the compulsory undoing of the action done in breach of the obligation.[199] In the obligations to give, the plaintiff does not have this option.[200] In the case of the obligations to give, plaintiffs have first to seek the enforcement of the obligation of giving, and only when it is not possible to comply with such obligation, can the plaintiff seek compensation.[201] Although

[189] BARROS (2006), p. 987.

[190] ABELIUK (2008), p. 369.

[191] BARROS (2006), p. 987.

[192] PATTERSON *et al.* (2012), p. 561.

[193] Civil Code, S. 1460.

[194] ABELIUK (2008), p. 370.

[195] ABELIUK (2008), p. 373.

[196] ABELIUK (2008), p. 373.

[197] ABELIUK (2008), p. 813.

[198] Civil Code, S. 1553.

[199] Civil Code, S. 1553.

[200] ABELIUK (2008), p. 813.

[201] ABELIUK (2008), p. 813.

the *Chilean Civil Code* does not expressly indicate this conclusion, authors have systematically construed the *Chilean Civil Code* reaching this conclusion.[202] Some authors go beyond this distinction and indicate that in all cases the first option of the plaintiff should be the compulsory performance of the obligation instead of direct compensation.[203]

The applicable regime in torts is different. Since the ground for compensation is the damage, the right that arises for the victim is always compensation.[204] The compensation arises to the victim because the main purpose of torts is to compensate a person injured by a breach of a standard of conduct that affects an interest protected by the law.[205] Consequently, there is no option between specific performances in torts law. It is always the right to compensation that arises.

The relevance of this for the heads of agreement analysis is crucial. If heads of agreement were considered contracts, the affected party by a breach would be entitled to enforce the specific obligation contained therein. For instance, if there were the obligation to provide certain information, the affected party would be entitled to enforce such obligation, obtaining the information stated in the agreement. More important is the case of the promise agreement. According to the *Chilean Civil Code*,[206] the promise agreement creates an obligation to do. This obligation to do means the obligation to sign the definitive agreement. Accordingly, if parties enter into a heads of agreement in the terms of a promise agreement, they will be creating an obligation to sign the definitive agreement. In practice, it is unlikely to see a party compelling the other to enter into an agreement. Even more if it supposes a long-term relationship. However, it is important to be aware of the legal consequences and effects of certain instruments. Legal advice cannot ignore the rights and duties that are being created; whether or not they are likely to occur.

On the other hand, if heads of agreement were considered preliminary negotiations, the only right that would arise in a case of breach of the standards of behaviour would be compensation. Consequently, there is no chance to compel the other party to perform specific actions. The only right that the victim has is a compensation for the loss suffered. This leads us to the other relevant point of the distinction: the differences in what can you obtain as compensation in these two different legal regimes.

4.5 The Compensatory Damages

There are two important issues regarding the remedies available to the victim of a breach of standards of care or contracts.[207] Both are related to the measure and remoteness of the damages to be compensated. As a foreword, the only damages recognised in the Chilean

[202] See, generally, ABELIUK (2008), pp. 812–814; BARCIA LEHMANN (2012), pp. 84–87; BARROS (2006), p. 987.

[203] BARROS (2006), p. 987.

[204] BARROS (2006), p. 987.

[205] BALKIN & DAVIS (2013), p. 4.

[206] Civil Code, S. 1553 and 1554.

[207] BARROS (2006), p. 990.

system are compensatory damages.[208] Within compensatory damages, there are two different categories. First, there are the proprietary damages, which refers to the economic losses of the victim.[209] Within them, there are direct losses and losses of profits.[210] The second category refers to losses that cannot be preliminary calculated in market terms.[211] In general, the Chilean authors refer to them as *moral damages*,[212] or also can be identified in a more sophisticated version as *non-pecuniary damages*.[213] The latter has relatively recently been recognised by the English law.[214]

The other relevant category that requires explanation is foreseeable and unforeseeable damages.[215] This category applies to proprietary damages above mentioned, and refers to the remoteness of the damages.[216] Foreseeable damages are those that were predictable at the time when the parties entered into an agreement,[217] or by the time of the occurrence of the breach of the standard of conduct.[218] On the contrary, unforeseeable damages are those that could not be expected by the parties at the time of entering into the agreement,[219] or the moment of the breach of the standard of conduct.[220] Having said that, it is possible to understand the differences between the both frameworks.

Extra-contractual liability operates the full compensation of the damage principle.[221] According to this principle, the injured person has to be placed in the condition where he or she was before the action that caused him or her damage.[222] Three important consequences arise from this principle. First, the quantum of the compensation must be in accordance with the damage caused and not with the seriousness of the offence.[223] Second, the quantum of the

[208] AZAR (2009), p. 24.

[209] RODRÍGUEZ GREZ (2009), p. 225.

[210] RODRÍGUEZ GREZ (2009), p. 225.

[211] RODRÍGUEZ GREZ (2009), p. 225.

[212] See, eg., RODRÍGUEZ GREZ (2009), p. 225; BARROS (2006), p. 990.

[213] See, generally, BARRIENTOS (2008).

[214] ATIYAH & SMITH (2005), p. 422.

[215] RODRÍGUEZ GREZ (2009), p. 229.

[216] Civil Code, S. 1558.

[217] RODRÍGUEZ GREZ (2009), p. 229.

[218] BANFI (2012), p. 3.

[219] RODRÍGUEZ GREZ (2009), p. 229.

[220] BANFI (2012), p. 3.

[221] Civil Code, S. 2329.

[222] DIEZ (1997), p. 160.

[223] DIEZ (1997), p. 161.

compensation must be equivalent to the damage caused.[224] Finally, and related to both previously mentioned, all damage suffered by the victim must be compensated.[225]

The third consequence is what triggers or evidences the main difference with the contractual compensatory regime.[226] Using the framework described above, the third consequence means that in a case of breach of a standard of conduct all the damage, namely, the direct losses, the losses of profits, and the moral damage, as well as all the unforeseeable damage must be compensated. As will be seen, the contractual regime does not follow the same rule.[227]

In contractual relations, the recognition of the full compensation of damage principle is limited.[228] The limits come from two different aspects. First, in the contractual regime the unforeseeable damages are only compensable when the defaulting party has acted with the intention to breach the agreement or wrongful misconduct.[229] Consequently, in cases of negligence, whichever is the standard of negligence required according to the specific agreement, unforeseeable damages are not compensable.[230]

The second significant difference refers to moral damages. In Chile, the compensation of moral damages within the contractual framework has been a matter of intense debate over the years.[231] Historically, moral damage has been repaired neither in the contractual nor the extra-contractual regime.[232] However, in the '20s the courts began to recognise it, but only for the extra-contractual regime.[233] During the '50s, the courts started to hesitate to include moral damage in contractual fields.[234] Today it is possible to find many judgements of the Chilean Supreme Court that recognise moral damage in contractual relations.[235] Besides these cases, the Chilean Supreme Court continue hesitating in the acknowledgement of moral damages in contractual responsibility because there is no explicit law that recognises it.[236] This hesitation creates a significant difference between the regimes. While there is a general agreement

[224] DIEZ (1997), p. 161.

[225] DIEZ (1997), p. 161.

[226] DOMÍNGUEZ HIDALGO (2012), p. 564.

[227] DOMÍNGUEZ HIDALGO (2012), p. 565.

[228] DOMÍNGUEZ HIDALGO (2012), p. 564.

[229] Civil Code, S. 1558.

[230] DOMÍNGUEZ HIDALGO (1998), p. 240.

[231] See JANA & TAPIA (2004), p. 173.

[232] JANA & TAPIA (2004), p. 176.

[233] JANA & TAPIA (2004), p. 176.

[234] JANA & TAPIA (2004), p. 176.

[235] See, eg., *Stange con Ripley Puerto Montt South Store* (2013); *Ocharan con Gonzalez* (2014); *Morín con Empresa Chilquinta Energía S.A.* (2010).

[236] JANA & TAPIA (2004), p. 180.

regarding the compensability of moral damages in torts, in contracts the Chilean Supreme Court and the doctrine have struggled to create a space for them.

Consequently, if heads of agreement were preliminary negotiations, the scope of the compensations would be broader than the contractual and, especially regarding the moral damages that may arise from the breach, there would be certainty that they are compensable.

As has been seen, the regime applicable to heads of agreement has many legal consequences. Lawyers and the relevant stakeholders cannot ignore these issues. However, we know that heads of agreement are an instrument designed by parties and, accordingly, they do not have a prior specific content. Thus, we need to address the issue whether they are agreements or not to attend to the rules that provide the Chilean system to identify the legal nature of them.

V. CONCLUSIONS

Heads of agreement are used internationally. Chile followed this practice probably to give more comfort to international investors that were used to them. However, the legal status and consequences of these documents within the Chilean legal system have not been studied. In this regard, this article has analysed and discussed the main questions regarding the legal status of heads of agreement in Chile. On this subject, the article has stated that due to its characteristics, heads of agreement can be contracts or preliminary negotiations instruments, each differently recognised by the Chilean law. The consequences of the categorisation are significant: what the compensable damages are, the negligence standards, or even the obligations assumed by the parties lies in this classification. Since the specific content of a heads of agreement is a matter of fact, this article has analysed the element that draws the line between preliminary negotiations and contracts: the consent. During preliminary negotiations, consent is not still formed, so there are no contractual obligations but standards of behaviour, while in contracts specific obligations are assumed and, accordingly, parties are entitled to enforce them.

Lawyers must understand their clients' interests and translate them into the legal world. The legal advice regarding heads of agreement must consider the different categories discussed. Failing on this matter or giving the wrong advice could be a terrible —and costly— mistake. This article aimed to analyse the main legal issues that heads of agreement have to face within the Chilean system and to provide the essential elements to avoid making such a mistake.

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