

# Liability for Contractual Negotiations in English Law: Looking for the Litmus Test

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## Abstract

*This paper aims at taking a critical look at the current state of English law on liability for contractual negotiations<sup>1</sup>, illustrating the extent to which English law is substantially different than other European legal systems in this respect, and also the extent to which this contrasts with current projects or existing texts of European or International harmonization of Contract law, namely, the EU Commission's Common Frame of Reference (CFR)<sup>2</sup>, the Principles of European Contract Law (PECL), the UNIDROIT Principles of Contract law and the UN Convention on the Law of International Sales of Goods (CISG).*

*A very important basic distinction must be made between the case where no Contract results from contractual negotiations and the case where the contractual negotiations result in the formation of a prima facie valid agreement between the parties, or an agreement that is avoided. This paper will concentrate on the former case, which is more interesting as English law in this case is still not settled, after a very brief look at the law applicable in the two latter cases.*

*Título: Responsabilidad precontractual en Derecho inglés: en búsqueda del Litmus test*

*Keywords: Contractual Negotiations; Pre-contractual Liability; English Law*

*Palabras claves: Negociación previa a la celebración de un contrato; Responsabilidad precontractual; Derecho inglés*

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<sup>1</sup> From the recent literature see: SCHWARTZ and SCOTT (2007); JACKSON (2007); MARKOVITS (2004); ARYE BEBCHUK and BEN-SHAHAR (2001); GROSSKOPF and MEDINA (2006); PEEL (2002); HIRD (2005); and GILKER (2002).

<sup>2</sup> A full "academic" draft of which has just been published and is available online: [Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference \(DCFR\)](#). On European Private law, see HOWELLS, JANSSEN and SCHULZE (2005); and, on the [UN Convention on the Law of International Sales of Goods \(CISG\)](#), see GODERRE (1997).

## 1. When negotiations result in a contract between the parties

When negotiations result in the formation of a valid contract, English courts have developed a series of techniques intended to deal with the parties' behaviour during the negotiating stage as behaviour bearing on the formation and content of the Contract. What is said or done, therefore, by the now contractual parties at the stage of negotiations, can have an impact on the construction and the validity of the Contract; i.e. defining the contractual terms, or whether mistake or misrepresentation has affected the parties' expression of their contractual intentions or have caused the parties wrongful loss, whether disclosure duties arising out of the special nature of the contract have been breached, or consent to enter into a Contract is vitiated by pre-contractual behaviour that is dishonest, threatening or implies undue influence in a fiduciary relationship.

Thus, and against the background of the more conservative approach of the House of Lords in *Investors Compensation Scheme Ltd v. West Bromwich Building Society* (No.1) summed up by Lord Hoffman as:

“(...) the law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent (...)”<sup>3</sup>.

It was recently confirmed in the Court of Appeal that use of materials in pre-contractual negotiations are allowed in the construction of the contractual terms, if not excluded by the parties<sup>4</sup>. Any mis-statements made in the course of negotiations can result in liability for any loss after the contract is formed, or, if they have induced the contract they can, under certain conditions, give to the other party the right to rescind a particular term or the whole agreement (Misrepresentation Act 1967). If the contract is one of utmost faith<sup>5</sup> (*uberrimae fidei*), then disclosure duties exist during the negotiation stage which, if breached, may give the other party the right to ask for the contract to be avoided<sup>6</sup>. Additionally, it should be noted that the UK has duly implemented the entire consumer law acquis of the EU that does, of course, introduce a

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<sup>3</sup> [1998] W.L.R. 896, p. 913.

<sup>4</sup> In *ProForce Recruit Ltd v. Rugby Group Ltd* [2006] EWCA Civ 69 (CA); see also *Chartbrook Ltd v. Persimmon Homes Ltd* [2007] EWHC 409 (Ch). JACKSON (2007) who concludes, however, that “(...) the extent to which pre-contractual negotiations can be used to interpret contracts remains unclear, especially in relation to undefined terms. Questions of interpretation come before the courts regularly and it is to be hoped that further guidance will be given on this point (...)”

<sup>5</sup> For instance, insurance contracts, marine insurance, motor insurance and reinsurance.

<sup>6</sup> See *Smith v. Hughes* [1871] LR QB 597; Marine Insurance Act 1906 s.17, s.18; *Drake Insurance Plc (In Provisional Liquidation) v. Provident Insurance Plc* [2003] EWCA Civ 1834, [2004] Q.B. 601 (CA (Civ Div)); *Brotherton v Aseguradora Colseguros SA* (No.2) [2003] EWCA Civ 705, [2003] 2 All E.R. (Comm) 298 (CA (Civ Div)); *WISE Underwriting Agency Ltd v. Grupo Nacional Provincial SA* [2004] EWCA Civ 962; [2004] 2 All E.R. (Comm) 613 (CA (Civ Div)); and *HIRD* (2005).

special regime of fair dealing for consumer Contracts, and which I have recently discussed elsewhere (BANAKAS, 2008).

The parties conduct during negotiations is also taken into account in apportioning liability for a Contract that is void or voidable. Thus, there is statutory liability under the Misrepresentation Act 1967 for intentional, negligent and even innocent misstatements. The party at fault may be faced with a demand for a rescission of the Contract and a claim for damages for any losses caused by such statements. Additionally, there can be liability in Tort for Negligence in common law. Such liability may arise especially by virtue of the reasonable reliance of the parties on each other during negotiations and of any evidence of an assumption of responsibility for statements made during negotiations, if a contract has resulted (BANAKAS, 1999 and 1996). If the contract is avoided, any benefits conferred during the negotiations can be recovered under principles of the Law of Restitution<sup>7</sup>.

## **2. When negotiations break up without an agreement**

### **2.1. No special rule of pre-contractual liability when no contract results**

Unlike in German or Italian law, and like in French law, no special rule of pre-contractual liability (*culpa in contrahendo*) exists in English law when no Contract results. It should also be pointed out from the outset that, unlike in all of these other major European legal systems, contractual liability in English law is narrowed down by the need for a contract to be founded on an exchange of benefits/detriments in order to be binding (the doctrine of consideration), unless it is an agreement made under seal. This makes it harder for any acts or statements in the pre-contractual stage to have any binding effect in law, if no contract is finally made as a result; only equitable remedies or tort liability remain as a possibility in such a case.

### **2.2. Is there duty to negotiate in Good Faith in English law? 8**

Good faith in Consumer Contracts is as much part of English law today, as it is of EU Consumer law; the Unfair Contract Terms Directive, and all the rest of the *acquis communautaire* in Consumer Protection law, has been duly integrated into national UK law.

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<sup>7</sup> After *Lipkin Gorman v. Karpnale Ltd* [1991] 2 AC 548, (affirmed in subsequent decisions: see, e.g. *Woolwich Equitable Building Society v. IRC* [1992] 3 All ER 737; *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council* [1996] AC 669; *Kleinwort Benson Ltd v Glasgow City Council* [1998] 1 AC 153), where the House of Lords acknowledged for the first time the existence of an autonomous cause of action in unjust enrichment, the Law of Restitution has become the new panacea in cases of disputed entitlement. See VIRGO (2006).

<sup>8</sup> From a vast literature on Good Faith in English Contract law see: MOUZAS and FURMSTON (2008); TETLEY (2004); BEATSON and FRIEDMANN (2002); HUNTER (1993); GOETZ and SCOTT (1981); LÜCKE, (1987); COLE (1994); TAYLOR (1997); GODDARD (1997); STEWART (1998); CHEYNE and TAYLOR (2001); WEBB (2001); CLARKE (1993).

But the issue of the place of good faith in English law remains controversial in the wider context of commercial and other business to business contracts, and this controversy has a direct impact on the law of pre-contractual negotiations, as any requirement of good faith in such negotiations to enter into a contract would not be possible if a similar requirement is not present in the performance of a valid contract<sup>9</sup>.

Writing in 1766, the great reformer judge Lord Mansfield sought to import good faith into English law as

“(...) the governing principle... applicable to all contracts and dealings (...)”<sup>10</sup>.

But he failed to achieve this, as, indeed, several others of his inspired reforms of English Contract law. The classical theory of English Contract law was perceived as promoting pragmatism, predictability and certainty<sup>11</sup>.

Good faith is of course a paramount consideration in Civil law systems<sup>12</sup>, running through the entire Law of Obligations. More prominently so in German law, where, as is well known, the general clause of paragraph 9 of the AGB-Gesetz, declares non-operative (*Unwirksam*) against the consumer stipulations contrary to *Treu und Glauben*, after a long period in which German courts already applied the principle of good faith to such stipulations, under paragraph 242 BGB. *Treu und Glauben* is in this context determined on objective criteria, with basic fundamental rights (*Grundrechte-through Drittwirkung*) and good market morals (*Verkehrssitten*) playing an important part. The difficulty for English judges lies in the fact that the approach of English law to basic rights, and the political ideology of the common law, is different than those of German law. The only equivalent to *Grundrechte* that English judges can turn to is the European Convention of Human Rights, incorporated into English domestic law as recently as the year 2000. Although English judges show respect, and are often inspired, by the Convention in developing the common law, there is no indication of anyone suggesting that the European Convention can be allowed a *Drittwirkung* in private law, and this is not the right time to open that particular Pandora's Box. As far as good market morals are concerned, the common law always had an eye for good market practices and the like, but only to the extent that this helped to import realism and considerations of market efficiency and common sense into judicial reasoning. It is difficult to think of any concept similar to *Verkehrssitten* that an English judge could work out and use.

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<sup>9</sup> As said by M. CLARKE (1993, p. 318), “[the] foundations of a general rule of good faith can be discerned in the common law dust”.

<sup>10</sup> *Carter v. Boehm* (1766) 97 ER 1162, p. 1164.

<sup>11</sup> But see A. F. MASON (2000, p. 70): “it later emerged, as is the case with many legal concepts rooted in formalism, that the element of certainty was illusory”.

<sup>12</sup> ZIMMERMANN and WHITTAKER (eds.) (2000).

Nevertheless, on the other side of the Atlantic, the US Uniform Commercial Code made the concept of good faith its “overriding and eminent principle”, by expressly using it in about fifty of its four hundred sections and implying it in many others. Section 1-203 of the UCC states that “every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement”. This obligation is *jus cogens* and cannot be contracted out. Section 1-201 UCC defines good faith as “honesty in fact in the conduct or the transaction concerned”. However, and for all intents and purposes, this has been understood by American lawyers as meaning very little more than procedural fairness, i.e. absence of fraud or other dishonesty, misrepresentation and the like. The American Restatement (Second) of Contracts has adopted a much broader concept of good faith; examples of bad faith given in paragraph 205 of the Restatement include “evasion of the spirit of bargain, lack of diligence and slacking off, wilful rendering of imperfect performance, abuse of the power to specify terms, interference with the other party’s performance or failure to co-operate”. The debate is still going on as to whether it is appropriate to understand good faith as an objective standard and not simply the subjective state of mind of the contractual party. Some American scholars, known as “Communitarians”, are arguing in favour of judges applying objective “community standards” of fairness and decency to contractual bargains, whereas other object strongly to this as being dangerous for commercial life. An English judge looking for enlightenment would find the American scene both confused and confusing. In my view the crux of the matter for English law is: when is a contractual term that works in the market place unfair? For, if a term does not work, it will be wiped out from market practice; and the courts already know how to protect consumers from unworkable terms, by using well-known techniques of implying other terms, and construing a contract in a way as to give it “business efficacy”.

To be sure, “Good Faith” as a principle to guide formation and execution of contracts visited the merry island of England in the Middle Ages under the influence of Canon law. But by the 19th century, and at least as far the Common law was concerned (as opposed to Equity), the commercial hyperactivity of English merchants and the prevailing liberal attitude in the jurisprudence of the courts narrowed down its significance for the law of Contract to a so-called rule of, clearly subjective, “good faith purchase”. This was a rule concerning purchase of property or commercial title and was nicely expressed in 1801, in the case of *Lawson v. Weston*<sup>13</sup> as the principle of “pure heart and empty head”. Any old influence of the Roman concept of objective *bona fides* through Canon law died a natural death in the 19th century. All this means that procedural, rather than substantive, fairness has been the main concern of English law. Unlike American courts, English courts will still, even today, not look into the “adequacy of the consideration”, and a gross imbalance in contractual obligations is something that the common law can still do nothing about. The ideological pedigree of English Contract law today is still that of post-Benthamite Utilitarianism, and even enlightened English scholars like Atiyah are impressed by Hayek’s neo-liberalism. If good faith requires an examination of the substantive, rather than procedural, fairness of the bargain, is this not simply part of a rather suspect general

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<sup>13</sup> 4 Espinasse, 56.

move away from the free market, in search for what Hayek calls the “mirage of social justice”?<sup>14</sup> To be fair to Atiyah, he himself rejects the extreme view that substantive fairness is impossible to achieve. Only, however, because he strongly believes that procedural fairness, on which English Contract Law has always been strong, leads to substantive fairness.

A very influential, and I dare say, enlightened English judge, raised as a lawyer in the mixed legal tradition of South Africa exposed to Roman-Dutch law, Lord Steyn, has repeatedly commented on the issue of the place of good faith in English Contract law. In an important study he noted that the emphasis of English law on an objective approach to contractual issues tends to make England somewhat infertile soil for the development of a generalized duty of good faith in the performance of contracts<sup>15</sup>. As succinctly put by the New Zealand Court of Appeal:

“(...) Classical contract law is based on certain implicit paradigm cases, the most common of which is the contract for an identified commodity between two strangers operating in a perfect spot market. Contractual principles provide a relatively rigid offer and acceptance format and are intolerant of such issues as indefiniteness, agreement to agree, and agreements to negotiate in good faith. Principles of classical contract law like the bargain theory of consideration, the objective theory of interpretation, and the rule that silence is not acceptance are particularly apt for contracts of this kind (...)”<sup>16</sup>.

It must be noted that the doctrine of consideration, although essentially different in nature and function than the doctrine of good faith, does import into English Contract law an element of objective good faith, so far as it requires that consideration should be of some value and not completely derisory, and that it should not be illegal or immoral. Be that as it may, and in a later paper, Lord Steyn pointed out that this formalistic approach endorsed by the new Zealand court was overtaken by the good sense of some of the judges who recognized that the function of the law of contract is to provide an effective and fair framework for contractual dealings based on achieving the reasonable expectation of the parties; and he added:

“(...) there is not a world of difference between the objective requirement of good faith and the reasonable expectations of parties (...)”<sup>17</sup>.

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<sup>14</sup> Any EU ambitions for “social justice” have always been seen as abhorrent in British politics, likely to damage the market, the economy, and cause unemployment and so on. But even in the wider EU environment social justice does not appear to influence greatly the projected codification of Contract law principles in the forthcoming Common Frame of Reference (*supra*). See “Social Justice in European Contract Law: a Manifesto” (2004), 10 *European Law Journal*, pp. 653-674, signed by a group of European academics opposed to the purely technical approach of the EU Commission’s Contract law initiatives that perpetuates old social and economic models of *laissez-faire* free market ideologies of the past.

<sup>15</sup> STEYN (1991, p. 132).

<sup>16</sup> In *Bobux Marketing Ltd v. Raynor Marketing Ltd* [2002] 1 NZLR 506, at [33].

<sup>17</sup> J. STEYN, (1997, p. 434).

The New Zealand Court of Appeal, often commended for its progressive take on the future of English law that sometimes leads the way also for English courts, recently agreed:

“Despite its tradition, however, the law of England... could not forever ignore the fundamental weakness of the classical conception of contract law... The fundamental flaw of the classical conception of contract law was its empirical premise that most contracts are discrete. That premise is false. Most commercial contracts are in fact relational contracts. The great bulk of contracts either create or reflect relationships. It is discrete contracts that are unusual, not relational contracts (...)”<sup>18</sup>.

But the somewhat older dictum of another influential judge, Lord Wilberforce, still holds true for the reality of English contract law today:

“(...) English law, having committed itself to a rather technical and schematic doctrine of contract, in application takes a practical approach, often at the cost of forcing the facts to fit uneasily into the marked slots of offer, acceptance and consideration (...)”<sup>19</sup>.

It is, therefore, still the case that no general duties of good faith, disclosure, confidentiality<sup>20</sup> or collaboration exist in English law today in the course of contractual negotiations, when no contract results; important exceptions do apply, however, as we shall now see in some more detail.

### 2.3. The special case of “lock-out” agreements

A leading modern authority in this area is the decision of the House of Lords in the case of *Walford v. Miles*, [1992] 2 AC 128. The defendants had agreed that, while they negotiated with the claimants for the sale of their business and property, they would not enter into negotiations with any third party. This agreement is known as a “lock-out” agreement. The defendants had, in fact, negotiated with a third party. After they had informed the claimants that they were breaking off negotiations with them, they then entered into an agreement to sell to that third party. The claimants sued on two grounds: breach of the ‘lock out’ agreement and misrepresentation. The House of Lords held that an agreement whereby one party agrees for consideration and for a specified period of time not to negotiate with anyone else in relation to a sale of property can be enforceable, but an agreement that is open-ended in terms of time is not enforceable. The House of Lords accepted that a “lock-out” agreement could be enforceable but held that the agreement in this case could not be binding as it amounted to an agreement to negotiate for an unspecified

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<sup>18</sup> In *Bobux Marketing Ltd v. Raynor Marketing Ltd* [2002] 1 NZLR 506, at [35].

<sup>19</sup> *New Zealand Shipping Co Ltd v. A M Satterthwaite & Co Ltd* [1975] AC 154, p. 167.

<sup>20</sup> But there may be liability in Tort, for Breach of Confidence: see *Douglas and another and others v. Hello! Limited and others* [2007] UKHL 21, in which it is made obvious that the tort is intended primarily to protect commercial confidence.



period. The defendant-vendor was not obliged to conclude the contract and would not know when he was entitled to withdraw from negotiations. Moreover, the House of Lords pointed out that the courts could not be expected to decide subjectively whether a proper reason for ending negotiations existed<sup>21</sup>.

But in his more far-reaching judgment, one of the Law Lords, Lord Ackner, made a number of important general statements on the modern English law of pre-contractual liability. Referring, first, to the issue of a duty to negotiate, which in English law may arise out of a specific agreement between two parties to negotiate only with each other (the “lock-in” agreement), he said (p. 29):

“(...) The reason why an agreement to negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty. The same does not apply to an agreement to use best endeavours. This uncertainty is demonstrated in the instant case by the provision which it is said has to be implied in the agreement for the determination of the negotiations. How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined ‘in good faith (...)’.

Lord Ackner also said:

“(...) while negotiations are in existence either party is entitled to withdraw from these negotiations, at any time and for any reason (...)’.

This is a rather uncompromising statement of principle that makes agreements to negotiate practically useless, as any damages for breach for such an agreement could be only nominal, if damages are assessed with reference to the “expectation” or “performance” interest of the other party.

Then Lord Ackner turned his attention to the notion of good faith itself:

“(...) However, the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. Mr Naughton [counsel for claimants] of course, accepts that the agreement upon which he relies does not contain a duty to complete the negotiations. But that still leaves the vital question: how is a vendor ever to know that he is entitled to

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<sup>21</sup> *Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd* [1975] 1 W.L.R. 297 CA (Civ Div) was cited with approval.

withdraw from further negotiations? How is the court to police such an 'agreement'? A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies. In my judgment, while negotiations are in existence either party is entitled to withdraw from these negotiations, at any time and for any reason. There can be thus no obligation to continue to negotiate until there is a 'proper reason' to withdraw. Accordingly, a bare agreement to negotiate has no legal Content (...)"

Still, it was held in *Walford v. Miles* that the claimant could be awarded damages for expenditure based on a reliance not on the performance of the agreement to negotiate (any such reliance could be easily shown by the defendants to have caused no more expenditure than the claimant would have occurred even if that agreement had been performed, resulting in no contract) but on a misrepresentation by the defendants of their state of mind when entering the lock-out agreement, i.e. that they had at that time no intention to negotiate with a third party, which could be seen as a false, even dishonest (therefore possibly fraudulent), statement of fact<sup>22</sup>. Indeed, as noted by another judge:

"(...) Under English law there is no general duty to negotiate in good faith, but there are plenty of other ways of dealing with particular problems of unacceptable conduct occurring in the course of negotiations without unduly hampering the ability of the parties to negotiate their own bargains without the intervention of the courts (...)"

Moreover, there is no reason why a 'lock out' agreement during contractual negotiations could not be enforceable when, as in the case of *Global Container Lines Ltd v Black Sea Shipping Co*<sup>23</sup>, the obligation not to negotiate with anybody else was supported by consideration, unless it is void for uncertainty<sup>24</sup>. Such uncertainty would be only present if the "lock out" agreement contained nothing which enabled the court to determine the duration of the obligation. But commercial

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<sup>22</sup> The present status of *Walford v. Miles* in English law has been summarized as follows in the leading textbook TREITEL (2007, paragraph 2-116): "[In] *Walford v Miles*...the defendants had agreed subject to contract to sell a property to the purchasers for £2 million and had (in breach of the ineffective "lock-out" agreement) sold it to a third party for exactly that sum, and the purchasers then claimed damages of £1 million on the basis that the property was (by reason of facts known to them but not the defendants) worth £3 million. If a duty to negotiate in good faith exists, it must be equally incumbent on both parties, so that it can hardly require a vendor to agree to sell a valuable property for only two-thirds of its true value when the facts affecting that value are known to the purchaser and not disclosed (as good faith would seem to require) to the vendor. The actual result in *Walford v Miles* (in which the purchasers recovered the sum of £700 in respect of their wasted expenses as damages for misrepresentation, [1992] 2 A.C. 128 at 136, but not the £1 million which they claimed as damages for breach of contract *ibid.* at 135) seems with respect, to be entirely appropriate on the facts, especially because the vendors reasonably believed themselves to be protected from liability in the principal negotiation by the phrase "subject to contract"."

<sup>23</sup> (Ch D) Chancery Division [1997] C.L.Y. 4535.

<sup>24</sup> In *Pitt v PHH Asset Management Ltd* (CA (Civ Div)) Court of Appeal (Civil Division) [1994] 1 W.L.R. 327, the Court of Appeal held that this was consistent with the reasoning of the House of Lords in *Walford v. Miles*.

contracts, supported by consideration but without any agreement as to the time when the contract is terminable, are subject to an implied term that the contract is terminable on reasonable notice; and consideration may sometimes be something feather light and not difficult to find in the slightest benefit/detriment for either party<sup>25</sup>. Both of these facts do not help legal certainty, and allow a lot of actual discretion to the courts in deciding the binding effect of 'lock out' agreements on a case-to-case basis.

#### 2.4. Agreements to use "best endeavours", or to achieve fair price or cost

Agreements to use 'best endeavours' are generally treated as any other agreement to negotiate. There is a solid amount of judicial decisions to the effect that an express agreement to use best or reasonable endeavours to agree on the terms of a contract is no more than an agreement to negotiate, and is not enforceable<sup>26</sup>. But if there is sufficient evidence of an intention of the parties to use best endeavours in order to advance the process of making the contract possible by taking necessary concrete steps, rather than a mere intention to fairly negotiate the substance of the contract, this may make such an agreement enforceable. As Millett LJ put it<sup>27</sup>:

"(...) An undertaking to use one's best endeavours to obtain planning permission or an export licence is sufficiently certain and is capable of being enforced: an undertaking to use one's best endeavours to agree, however, is no different from an undertaking to agree, to try to agree, or to negotiate with a view to reaching agreement; all are equally uncertain and incapable of giving rise to an enforceable obligation (...)"

Again in the benchmark case of *Walford v. Miles*, Lord Ackner did seem to allow some room for certain negotiation agreements, such as agreements to use "best endeavours", to be binding. So they should be, of course, if limited in time and supported by consideration. This is, however, bound to be true with any agreements to negotiate, including agreements to negotiate in good faith, provided they were made clearly limited in time and backed by consideration. It is not, therefore, the notion of negotiating in good faith that is so unacceptable to English law, but that of negotiating in good faith without consideration. That does exclude an automatic implication *ex*

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<sup>25</sup> The somewhat illusory nature of the doctrine of consideration is well exposed in P.S. Atiyah, "Consideration: A Restatement", in P.S. ATIYAH, (1986, p. 179).

<sup>26</sup> *Little v Courage* [1995] 70 P & CR 469; *London & Regional Investments Ltd v TBI plc Belfast International Airport Ltd* [2002] EWCA Civ 355 at [39]; *Multiplex Constructions UK Ltd v Cleveland Bridge UK Ltd* [2006] EWHC 1341 (TCC).

<sup>27</sup> *Little v Courage* (1995) 70 P & CR 469, at 475; accordingly, in *Multiplex Constructions UK Ltd v Cleveland Bridge UK Ltd* [2006] EWHC 1341 (TCC), a case that arose from the long delayed construction of the new Wembley Stadium in London, Jackson J. held unenforceable a provision in an interim settlement agreement that "the parties shall use reasonable endeavours to agree to re-programme the completion of the subcontract works and to agree a fixed lump sum and/or reimbursable subcontract sum for the completion of subcontract works".

*lege* of such a duty<sup>28</sup>, but things should be different if the duty to negotiate in good faith has been agreed by the parties. Indeed, if the duty to negotiate in good faith is agreed as reciprocal this would offer enough consideration for both parties to one another, the only remaining issues being that the agreement to negotiate must have a clearly agreed duration, and that the parties must have agreed some basic aspects of the good faith they would be expected to show (a “lock-out” agreement would be a good example).

This possibility is illustrated by the analysis by Longmore LJ in the *Petromec* case<sup>29</sup>. Speaking *obiter* the judge accepted that a provision in an agreement for the upgrade of a vessel, in which the parties agreed to “negotiate in good faith”, any extra costs of such an upgrade was enforceable, as it was a provision referring to a specific and determined obligation and the agreement was not, therefore, a “bare agreement to negotiate”. The judge accepted that in using that phrase in *Walford v. Miles*, Lord Ackner did not exclude the possibility that a pre-contractual agreement to negotiate may contain an agreement on all essential points showing the parties’ intention to be legally bound, although leaving some other points open. In such cases, a term that the parties must negotiate in good faith in order to agree details to be incorporated in the full terms of the future contract between them may be implied by the court<sup>30</sup> and any express term to negotiate in good faith<sup>31</sup> may also be enforceable.

Longmore LJ in *Petromec* even appeared to suggest that the House of Lords might want to review the benchmark decision in *Walford v. Miles*, to the extent that it was based on the difficulty of assessing the loss caused by an agreement to negotiate: as said above, an assessment based on the reliance interest of the other party is not possible, and one based on the expectation interest uncertain. Quite rightly<sup>32</sup>, Longmore LJ drew an analogy with claims for loss of a chance<sup>33</sup>.

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<sup>28</sup> As provided in both the PECL and the UNIDROIT principles; when either of these principles apply, violation of the good faith requirement in the stage of contractual negotiations is, according to the ECJ, a matter of Tort liability for the purposes of article 5 (3) of the Brussels Convention: ECJ Case C-334/00, 17/09/2002 (*Tacconi*), where the European Court of Justice decided that in the light of “ (...) the absence of obligations freely assumed by one party towards another on the occasion of negotiations with a view to the formation of a contract and by a possible breach of rules of law, in particular the rule which requires the parties to act in good faith in such negotiations, an action founded on the pre-contractual liability of the defendant is a matter relating to tort, delict or quasi-delict within the meaning of Article 5(3) of the Brussels Convention (...)”.

<sup>29</sup> *Petromec Inc v Petroleo Brasileiro SA Petrobras* (No.3) (CA (Civ Div)) Court of Appeal (Civil Division) [2005] EWCA Civ 891.

<sup>30</sup> As in the case of *Donwin Productions Ltd v EMI Films Ltd*, THE TIMES, March 9, 1984 (not cited in *Walford v. Miles*).

<sup>31</sup> E.g. that the contract will be fixed at a ‘fair price’ or cost. In *Perry v Suffields Ltd* [1916] 2 Ch 187, a contract for the sale of land was held enforceable despite the fact that the parties had only agreed the bare essentials, through implication of the duty of good faith as to the fairness of the price.

<sup>32</sup> See, however, the objections in this respect of PEEL (2002, p. 11).

<sup>33</sup> Well-recognised by English law in cases of breach of contract: see *Chaplin v Hicks* [1911] 2 KB 786. In *Harrison v Bloom Camillin* (No.2) [2000] Lloyd’s Rep PN 89. compensating the claim for loss of a chance involved assessing

Even as things stand, with *Walford v. Miles* still in place, judges do not apply *Walford v Miles* to deny enforcement of a good faith clause, when such a clause refers to a specific mechanism or procedure of future contractual negotiations, especially, if it provides that the parties have a duty to conduct negotiations reasonably, but still deny the existence of a general duty to negotiate in good faith<sup>34</sup>. Thus, in *Tramtrack Croydon Ltd v. London Bus Services Ltd*<sup>35</sup>, Tramtrack held the concession to run the Croydon Tramlink. Under clause 23 of the amended concession agreement between Tramlink and the defendant London Bus Services, Tramlink had to accept certain tickets and passes as valid on the Tramlink and also such additional tickets and passes as were specified by the regulator from time to time. In respect of such tickets or passes the clause provided that the parties should in good faith agree, acting reasonably, the financial arrangements to be put in place to compensate Tramlink for their introduction. The judge, Christopher Clarke J, held that the good faith clause was not devoid of legal content, having duly considered *Walford v. Miles*. The parties did not limit their agreement to a “bare” obligation to act in good faith. They agreed to act reasonably in agreeing and that any failure to agree should be referred to expert determination. In those circumstances the court could decide, in the case of dispute, at least what they, and the expert, acting reasonably, were bound to take into account or ignore. Reasonableness was a criterion on which the court, and the expert, could make a judgment and, if the parties could not agree whether it would be unreasonable to take into account, or to exclude, a particular consideration, the court could determine the question. To be sure, English courts feel much more comfortable with the notion of reasonableness, embedded for a long time in English law and closely linked to ideas of objective interpretation of agreements and business efficacy, than the notion of good faith.

## 2.5. Negotiating partnership agreements

In *Conlon v Simms*<sup>36</sup>, the Chancery Court affirmed that partners have a duty to negotiate partnership agreements in good faith<sup>37</sup>, and of disclosure of all material facts, owed not only to existing partners but also prospective partners who are negotiating entry into the partnership.

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whether a claim against a third party would have succeeded had it not failed as a result of the defendant’s breach of contract.

<sup>34</sup> See, *Bernhard Schulte GmbH & Co KG v. Nile Holdings Ltd* (QBD (Comm)) Queen's Bench Division (Commercial Court) [2004] EWHC 977 (Comm), applying *Walford v. Miles*; *Abdale (t/a GFA) v. Alstom UK Ltd* (No.2) 2000 WL 989503 (QBD (TCC)) Queen's Bench Division (Technology & Construction Court), where it was held that if the parties had expressly agreed a co-operation clause then it would be wrong, with the benefit of hindsight, to imply an additional term of good faith. Such a term would have been superfluous since the kind of agreement which included a cooperation clause, necessarily anticipated a relationship of mutual trust and confidence. But if no such co-operation clause had been agreed, then a term of good faith could not be implied by virtue of the reasons in *Walford v. Miles*.

<sup>35</sup> (QBD (Comm)) Queen's Bench Division (Commercial Court) [2007] EWHC 107 (Comm).

<sup>36</sup> [2006] EWHC 401 (Ch).

## 2.6. Fiduciary relationships – Proprietary estoppel

Exceptionally in cases of contracts for the sale of land, equity has developed a doctrine that protects reliance in good faith of a party on the other party's actions during contractual negotiations, known as proprietary estoppel. A good definition of the doctrine of proprietary estoppel is the following:

“(...) Proprietary estoppel exists to adjust the prevailing balance of property between claimant and defendant when the claimant has formed the relevant kind of expectation, and has acted detrimentally in reliance on it, and these occurrences are ascribable to the defendant (via his encouragement of or acquiescence in them), so that it would be unconscionable for him to insist on the status quo (...)”<sup>38</sup>.

An illustration of the operation of this very important doctrine can be seen in the recent case of *Yeoman's Row Management v. Cobbe*<sup>39</sup>. The claimant, Mr. Cobbe had agreed in principle with the defendants Yeoman's Row Management (YRM), to buy property from them, on the basis of an expectation of acquiring from them for re-development the property, for which he had been encouraged by them to apply for, and obtain, detailed planning permission, in the belief that YRM would not withdraw from a promise to sell the property to him on agreed terms. In all this Mr. Cobbe had been encouraged and induced to act by the conduct of the controlling director of YRM. As soon as permission was obtained, the YRM walked out of the agreement in principle and demanded a big increase in the price, from £12m to £20m. Further negotiations between the parties then broke down.

The first instance judge granted equitable relief by concluding that this was a case of proprietary estoppel. The relief took the form of a share, secured on the property by a lien and calculated by reference to the amount by which the planning permission obtained by the claimant had increased the value of YRM's property as at the date when YRM withdrew from the promised contract. Before the Court of Appeal, the defendants' lawyer argued that there “was nothing unconscionable in withdrawing from a promise where the party to whom the promise was made was not entitled to rely on it in the first place”<sup>40</sup>. But Mummery LJ agreed with the trial judge that:

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<sup>37</sup> See also Partnership Act 1890, s. 28: “Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives”.

<sup>38</sup> GARDNER, (1999, p. 508).

<sup>39</sup> [2006] EWCA Cov 1139 (CA).

<sup>40</sup> [2006] EWCA Cov 1139 (CA), at [53].

“(…) proprietary estoppel could be established even where the parties anticipated that a legally binding contract would not come into existence until after planning permission had been obtained, further terms discussed and agreed and formal written contracts exchanged...[e]ven the use of the expression “subject to contract” would not, however, necessarily preclude proprietary estoppel if the claimant established that the defendant had subsequently made a representation and had encouraged on the part of the claimant a belief or expectation that he would not withdraw from the “subject to contract” agreement or rely on the “subject to contract” qualification (...)”<sup>41</sup>.

## 2.7. Constructive trusts<sup>42</sup>

Identified by Lord Browne-Wilkinson<sup>43</sup> as a trust

“(…)which the law imposed on [the trustee] by reason of his unconscionable conduct (...)”.

The constructive trust, especially the common intention constructive trust is fascinatingly close to proprietary estoppel<sup>44</sup>, may, indeed, be seen as underpinning it. A full account of the mechanics and uses of constructive trusts is well beyond the scope of this paper, but it should be pointed out that they can be used to imply duties of good faith and fair dealing in many situations where there is evidence of unconscionable conduct and the relationship of the parties is of a fiduciary character.

## 2.8. Restitution of unjust enrichment when negotiations fail

As already mentioned, English law has relatively recently embraced a general principle of restitution of unjust enrichment<sup>45</sup>. Cases in which a party to failed negotiations has claimed restitution of the unjust enrichment of the other party as a result of the failure to make a contract include *William Lacey (Hounslow) Ltd v Davis*<sup>46</sup>, in which the claimants were builders that made costly preparations for rebuilding premises that they were negotiating to take over for reconstruction from the owners, who, however, sold the premises to a third party instead of going ahead with the reconstruction. The court held that the claimants were entitled to an award

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<sup>41</sup> [2006] EWCA Civ 1139 (CA), at [57].

<sup>42</sup> MCGHEE (ed.) (2004).

<sup>43</sup> In *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council* [1996] AC 669, 705; (1996) 112 LQR 521 (Cape); [1996] CLJ 432 (Jones); [1997] LMCLQ 441 (Stevens).

<sup>44</sup> S. NIELD (2003).

<sup>45</sup> *Lipkin Gorman v. Karpnale Ltd* [1991] 2 AC 548.

<sup>46</sup> [1957] 1 WLR 932.

*quantum meruit* for the work they had done. But, as shown by the failure of the claimants in the case of *Regalian Properties Plc v London Docklands Development Corporation*<sup>47</sup>, *quantum meruit* compensation of work done during contractual negotiations can only be claimed if the work in question has clearly benefited financially the other party, who broke the negotiations. This is in accordance with the restitutionary nature of this special liability during the stage of contractual negotiations.

### 3. Conclusions

English law presents the viewer in the area of liability for pre-contractual negotiations with a familiar landscape. No structured system of principles, rules and exceptions, but a historically and systematically fragmented sanction of special instances of wrong or unconscionable conduct, with remedies drawn from equity, tort and restitution. Unless, that is, an agreement is reached by the parties at the end of the negotiating stage, when any such conduct may be sanctioned in relation to its effect on the validity of the agreement and the determination of its valid terms, and liability (contractual and also, potentially, tortious) may be imposed.

Despite several critical views to the contrary, English law still refuses to imply general duties of good faith, fair dealing, disclosure and confidentiality at the negotiating stage<sup>48</sup>. In this, it still offers a clear alternative to [EU Commission's Common Frame of Reference](#), the [Principles of European Contract Law](#)<sup>49</sup>, the [UNIDROIT Principles of International Commercial Contracts](#) (art.

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<sup>47</sup> [1995] 1 WLR 212.

<sup>48</sup> However, and under the influence of one of its most eminent Law Commissioners and long-standing supporter of the Principles of European Contract Law (of which he was a principal co-author), Professor Hugh Beale, and prompted by another eminent 'pro European' English academic lawyer, Professor Sir Roy Goode, the U.K. Law Commission announced in 1999 that it was contemplating a commercial code for England and Wales, which would not contain detailed rules, but general underlying principles, similar to those found in the Principles of European Contract Law and the UNIDROIT Principles of International Commercial Contracts. See Law Commission Report No. 259, *The Law Commission Seventh Programme of Law Reform*, published June 15, 1999, section 1.14. This tentative announcement has had no sequel, as the Law Commission had made it clear that they would be involved in this only after obtaining the approval of the Lord Chancellor, which has not been granted so far.

<sup>49</sup> The Principles of European Contract Law provide comprehensive provisions of good faith before and during a contractual relationship. Article 1:201, entitled "Good Faith and Fair Dealing", states that: "(1) Each party must act in accordance with good faith and fair dealing", and "(2) The parties may not exclude or limit this duty". Article 1:202, entitled "Duty to Co-operate", states that "Each party owes to the other a duty to co-operate in order to give full effect to the contract". Section 3, entitled "Liability for negotiations", contains two articles. Article 2:301, entitled "Negotiations Contrary to Good Faith" states that '(1) A party is free to negotiate and is not liable for failure to reach an agreement; (2) However, a party who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party; (3) It is contrary to good faith and fair dealing, in particular, for a party to enter into or continue negotiations with no real intention of reaching an agreement with the other party'. And Article 2:302, entitled "Breach of Confidentiality", states that



1.7)<sup>50</sup>, and the UN Convention on the Law of International Sales of Goods<sup>51</sup>, all of which endorse broadly similar versions of a general duty of good faith and fair dealing in negotiating contracts. It should be also pointed out that rules of *culpa in contrahendo* are laid down by art. 12 of the [Regulation \(CE\) No. 864/2007 of the European Parliament and the Council of 11 July 2007, relative to the law applicable to extra-contractual obligations \(«Rome II»\)](#).

The perceived practical advantage of the conservative approach of English law in its refusal to accept *culpa in contrahendo*, is that this helps English law to retain its special distinctive identity and style as a competitor in the International market of choice of law-shopping, even offering a sharper practical conservatism than its greatest common law rival, the New York contract law<sup>52</sup>. Whatever the merits or otherwise of such conservatism from the point of view of general market efficiency<sup>53</sup>, and arguments that it goes against an emerging trend of adherence to good faith

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“If confidential information is given by one party in the course of negotiations, the other party is under a duty not to disclose that information or use it for its own purposes whether or not a contract is subsequently concluded. The remedy for breach of this duty may include compensation for loss suffered and restitution of the benefit received by the other party”.

<sup>50</sup> E. A. FARNSWORTH, (1995, pp. 47-49) gives an account of various other provisions of the UNIDROIT Principles which refer to good or bad faith or fair dealing.

<sup>51</sup> [United Nations Convention On Contracts For The International Sale Of Goods](#), adopted at Vienna, April 11, 1980 and in force January 1, 1988. Article 7(1) states that “In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade”. Commentators seem to agree generally that there is little point in confining this article, on a narrow interpretation, to the interpretation of the provisions of the Convention itself and not extending its application to the conduct of contracting parties, as a broader interpretation would suggest: see TETLEY (2004, XI.1). See also U. MAGNUS, [“Remarks on good faith: The United Nations Convention on Contracts for the International Sale of Goods and the UNIDROIT Principles of the International Commercial Contracts”](#), Pace University School of Law. A further argument in favor of the broader interpretation is that the Vienna Convention was actually modeled on the UNIDROIT principles that explicitly endorse a duty of good faith of contracting parties during negotiations: see *supra*.

<sup>52</sup> Which evolves in a more positive, albeit often confusing, environment for ideas of good faith, influenced by the UCC and the Restatement (Second) of Contracts, and the broader approach to promissory estoppel of American law. On American law generally, see recently SCHWARTZ and SCOTT (2007, pp. 661-662): “For decades, there has been substantial uncertainty regarding when the law will impose precontractual liability. The confusion is partly due to scholars’ failure to recover the law in action governing precontractual liability issues... no liability attaches for representations made during preliminary negotiations. Courts have divided, however, over the question of liability when parties make reliance investments following a “preliminary agreement”. A number of modern courts impose a duty to bargain in good faith on the party wishing to exit such an agreement. Substantial uncertainty remains, however, regarding when this duty attaches and what the duty entails.”

<sup>53</sup> See E. MACKAAY and V. LEBLANC, [“The Law and Economics of Good Faith in the Civil law of Contract”](#), paper prepared for the 2003 Conference of the European Association of Law and Economics, at Nancy, France, 18-20 September 2003; GROSSKOPF and MEDINA, (2006); MARKOVITS (2004).

principles in International Contracts practice and International Arbitration practice<sup>54</sup> notwithstanding, this conservatism has served well English law and its international ambitions, by offering a reassurance, if not a reality<sup>55</sup>, of practical certainty and making it, therefore, attractive to international negotiating parties as their law of choice. It remains, however, a significant thorn on the side of any broader European harmonisation project in the field of pre-contractual negotiations, i.e. beyond business to consumer pre-contractual relations.

#### 4. Case law

<i>Case</i>	<i>Reference</i>
<i>Abbale (t/a GFA) v. Alstom UK Ltd</i>	[2000] WL 989503
<i>Bernhard Schulte GmbH &amp; Co KG v. Nile Holdings Lt</i>	[2004] EWHC 977
<i>Bobux Marketing Ltd v. Raynor Marketing Ltd</i>	[2002] 1 NZLR 506
<i>Brotherton v Aseguradora Colseguros SA</i>	[2003] EWCA Civ 705
<i>Carter v. Boehm</i>	[1766] 97 ER 1162
<i>Chaplin v. Hicks</i>	[1911] 2 KB 786
<i>Chartbrook Ltd v. Persimmon Homes</i>	[2007] EWHC 409
<i>Cobbe v. Yeoman's Row Management Ltd</i>	[2006] EWCA Civ 1139
<i>Conlon v. Simms</i>	[2006] EWHC 401
<i>Courtney &amp; Fairbairn Ltd v. Tolaini Brothers (Hotels) Ltd</i>	[1975] 1 W.L.R. 297
<i>Donwin Productions Ltd v. EMI Films Ltd</i>	[1984] QBD THE TIMES, March 9
<i>Douglas and another and others v. Hello! Limited and others</i>	[2007] UKHL 21
<i>Drake Insurance Plc v. Provident Insurance Plc</i>	[2003] EWCA Civ 1834
<i>Global Container Lines Ltd v. Black Sea Shipping Co</i>	[1997] C.L.Y. 4535
<i>Harrison v. Bloom Camillin</i>	[2000] Lloyd's Rep PN 89
<i>Investors Compensation Scheme Ltd v. West Bromwich Building Society</i>	[1998] W.L.R. 896
<i>Kleinwort Benson Ltd v. Glasgow City Council</i>	[1998] 1 AC 153
<i>Lipkin Gorman v. Karpnale Ltd</i>	[1991] 2 AC 548
<i>Little v. Courage</i>	[1995] 70 P & CR 469
<i>London &amp; Regional Investments Ltd v. TBI plc Belfast International Airport Ltd</i>	[2002] EWCA Civ 355
<i>Multiplex Constructions UK Ltd v. Cleveland Bridge UK Ltd</i>	[2006] EWHC 1341
<i>New Zealand Shipping Co Ltd v. A M Satterthwaite &amp; Co Ltd</i>	[1975] AC 154
<i>Perry v. Suffields Ltd</i>	[1916] 2 Ch 187
<i>Petromec Inc v. Petroleo Brasileiro SA Petrobras</i>	[2005] EWCA Civ 891
<i>Pitt v. PHH Asset Management Ltd</i>	[1994] 1 W.L.R. 327
<i>ProForce Recruit Ltd v. Rugby Group Ltd</i>	[2006] EWCA Civ 69
<i>Regalian Properties Plc v. London Docklands</i>	[1995] 1 WLR 212

<sup>54</sup> See TETLEY (2004).

<sup>55</sup> See MASON (2000).

<i>Development Corporation</i>	
<i>Smith v. Hughes</i>	[1871] LR QB 597
<i>Tramtrack Croydon Ltd v. London Bus Services Ltd</i>	[2007] EWHC 107
<i>Walford v. Miles</i>	[1992] 2 AC 128
<i>Westdeutsche Landesbank Girozentrale v. Islington London Borough Council</i>	[1996] AC 669
<i>William Lacey (Hounslow) Ltd v. Davis</i>	[1957] 1 W.L.R. 932.
<i>WISE Underwriting Agency Ltd v. Grupo Nacional Provincial SA</i>	[2004] EWCA Civ 962
<i>Woolwich Equitable Building Society v. IRC</i>	[1992] 3 All ER 737
<i>Yeoman's Row Management v. Cobbe</i>	[2006] EWCA Civ 1139

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