

# A contractual obligation to negotiate in good faith – binding or not binding?

Express obligations to negotiate documents in good faith are often encountered in financing transactions, particularly in commitment papers. Before 2005, it was accepted law that an obligation to negotiate in good faith was not enforceable. The Court of Appeal's comments in the *Petromec* case of that year ruffled feathers a little by suggesting that in some circumstances an express obligation to negotiate in good faith may be enforceable. However, in the recent decision of *Barbudev v Eurocom* the High Court has returned to the previous position that such an obligation is always unenforceable. As the ruling of a first instance court only, this decision is not binding on other courts and does little to clarify the extent to which an express obligation to negotiate in good faith will be binding. Its significance is that it seems to signal a reluctance on the part of the lower courts to build on, or follow, the Court of Appeal's lead in *Petromec*.

## Background

Obligations to negotiate documents in good faith are common in financing transactions, most notably in the context of signed commitment letters attaching agreed term sheets. The term sheet then forms the basis of negotiations on the details of the finance documents. The commitment letters often contain an obligation to negotiate the finance documents in good faith. This obligation was not considered enforceable until the Court of Appeal's suggestion in *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2005] EWCA Civ 891 that an obligation to negotiate in good faith may be enforceable in some instances. Our client briefing [A Legal Obligation to Negotiate in Good Faith?](#) examined that decision and its potential consequences in more detail. The Court of Appeal's comments in *Petromec* were not necessary for its decision, but the main implication for the banking market seemed to be that it would be wrong to assume that an obligation to negotiate in good faith could never be binding. The decision potentially offered a stepping-stone for other judges to depart from the conventional wisdom.

## Recent High Court decision

The High Court recently examined an express obligation to negotiate in good faith in *Barbudev v Eurocom Cable Management Bulgaria* [2011] EWHC 1560 (Comm). The facts were complicated but in essence the court had to determine whether a side letter outlining a proposed equity investment was binding. On the facts the judge found that the side letter was too uncertain to be enforced because it did not address all the essential terms required for the proposed investment.

## High Court's consideration of an express obligation to negotiate in good faith

The side letter in *Barbudev* contained an express obligation to negotiate the detailed terms of the investment in good faith. When considering the enforceability of this obligation, the judge mentioned *Petromec* in passing but preferred to rely instead on a passage from an academic work.

## Key Issues

- High Court asserts that an express obligation to negotiate in good faith is not enforceable
- Difficult to reconcile with comments in the Court of Appeal in *Petromec v Petroleo Brasileiro* in 2005
- The extent to which an express obligation to negotiate in good faith is binding remains unclear

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The court endorsed the view that:

- an agreement to negotiate in good faith without more is always unenforceable in English law;
- an agreement to negotiate in good faith may be enforceable if the parties have set out objective criteria, or machinery for resolving any disagreement, but in those circumstances the reality is that the court completes the parties' agreement by reference to the objective criteria or the machinery rather than by enforcing the agreement to negotiate; and
- an otherwise enforceable agreement that contains an agreement to negotiate in good faith over additional terms does not become unenforceable as a whole because of the agreement to negotiate, but the agreement to negotiate is not enforceable.

*Barbudev* represents a reassertion of the traditional position taken by English law, rejecting the attempts at modernisation in *Petromec*. In *Petromec*, the Court of Appeal considered that if the parties had taken the trouble to include an obligation to negotiate in good faith in a contract drafted by lawyers, the courts should be slow to conclude that the obligation was without legal substance. In *Barbudev*, Blair J said that it was too difficult to decide whether or not the parties had negotiated in good faith, what agreement the parties would have reached had they complied with the obligation, and therefore what loss was caused by the breach. The result was that an agreement to negotiate in good faith was too uncertain for the courts to enforce.

### Where does this leave us?

The Court of Appeal's statements in *Petromec* were not binding precedent because the point was not necessary for its decision. However, they were (and are) a guide to how some courts may approach this point in the future and so raised the possibility that an express obligation to negotiate in good faith may be held to be enforceable.

The decision in *Barbudev* was that of a lower court only, is not binding on other courts and so does not mean that the possibility can be dismissed. The traditional position taken by English law is at odds with the approach in much of continental Europe, and has many critics in England. The extent to which an express obligation to negotiate in good faith may be enforceable therefore remains unclear.

However, the decision does have practical significance. It is a sign that the lower courts may be more reluctant than the higher courts to complete an agreement for the parties even if the court concludes that the parties intended the agreement to be legally binding. For example, the approach taken in *Barbudev* mirrored that of another recent first instance case, *Dhanani v Crasnianski* [2011] EWHC 926 (Comm), in which the judge found that a term sheet outlining the establishment of a private equity fund was too uncertain to be enforced. If the risk or opportunity was that *Petromec* could act as a stepping-stone for other cases to find that an obligation to negotiate in good faith was binding, *Barbudev* might be an indication that lower courts at least are reluctant to cross that particular river.

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