

Arbitration & ADR - United Kingdom

Duty to negotiate before arbitration held to be enforceable

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Introduction

In commercial contracts, parties frequently agree to negotiate before submitting a dispute to formal arbitration or litigation proceedings. The purpose of such agreements is to encourage parties to reach an early settlement of the dispute, thereby reducing time, cost and potential damage to the ongoing business relationship that may result from the parties' positions becoming entrenched in formal proceedings.

While the commercial purpose of agreements to negotiate is clear, their legal status is not. The question as to whether such agreements are bare 'agreements to agree', devoid of legal content, or whether they are legally enforceable has been the subject of a number of decisions.

English courts have generally adopted the view that such agreements are not sufficiently certain to be enforceable. However, the recent decision in *Emirates Trading Agency LLC v Prime Mineral Exports Private Limited* marks a departure from this approach.⁽¹⁾

Facts

In October 2007 Emirates Trading Agency LLC entered into a long-term contract to buy fixed quantities of iron ore from Prime Mineral Exports Private Limited.

The dispute resolution clause provided, at Clause 11.1:

"In case of any dispute or claim arising out of or in connection with or under this [contract], the Parties shall first seek to resolve the dispute or claim by friendly discussion. Any party may notify the other Party of its desire to enter into consu[lt]ation to resolve a dispute or claim. If no solution can be arrived at in between the Parties for a continuous period of 4 (four) weeks then the non-defaulting party can invoke the arbitration clause and refer the disputes to arbitration."

During the first two years of the contract, Emirates failed to lift any of the fixed quantities it had undertaken to buy from Prime. Prime terminated the contract in December 2009 and claimed liquidated damages from Emirates. The parties held several meetings both before and after the notice of termination was filed. However, the dispute was not settled. In June 2010 Prime submitted its damages claim to arbitration. The arbitral tribunal issued an award that confirmed that it had jurisdiction to hear Prime's claim.

Emirates applied to the High Court under Section 67 of the Arbitration Act 1996 to challenge the tribunal's award on the grounds that it lacked jurisdiction. Emirates argued that the requirement in Clause 11.1 of the contract to pursue friendly discussions for four weeks was a condition precedent to commencing arbitration proceedings. Therefore, the requirement had not been fulfilled because the parties had not pursued discussions to resolve their dispute for a continuous period of four weeks before Prime commenced proceedings.

Prime contended in response that the agreement to negotiate was not an enforceable condition precedent and that, even if it were enforceable, it had been satisfied.

The High Court judge rejected Emirates' challenge and upheld the award in favour of Prime.

Decision

In reaching his decision, the judge considered how the duty to negotiate at Clause 11.1 should be construed, whether it was enforceable and, if so, whether it had been satisfied.

How should Clause 11.1 be construed?

Authors

Marie Berard



Katharina Lewis



The judge accepted Emirates' argument that the requirement in Clause 11.1 to seek resolution of the dispute by friendly discussion amounted to a condition precedent to the right to refer the claim to arbitration. He held that the use of the word "shall" in the first part of the clause indicated that the obligation was mandatory.

However, the judge rejected Emirates' argument that the second part of Clause 11.1 required such discussions to continue for four weeks. The judge held that the meaning to be attributed to the words was that if no solution could be found for a continuous period of four weeks – notwithstanding the friendly discussions taking place – Prime could file for arbitration. While the discussion could last for less than four weeks, a party would have to wait for four weeks to elapse before commencing arbitration.

Was Clause 11.1 enforceable?

Prime argued that Clause 11.1 was not enforceable, relying to the decision in *Walford v Miles* in support of its contention.⁽²⁾ In that case, the House of Lords held that a bare agreement to negotiate was unenforceable because it lacked the necessary certainty. Further, it held that a duty to negotiate in good faith was inherently inconsistent with the position of the negotiating party, who had to be free to withdraw from the negotiations in order to advance his or her own interests. The House of Lords in *Walford v Miles* concluded that an agreement to negotiate was unworkable in practice and impossible for the courts to police.

However, referring primarily to Australian and Singaporean authority, Emirates argued that *Walford v Miles* and subsequent English decisions could be distinguished and that the duty to negotiate in Clause 11.1 was enforceable.

The judge agreed. He held that the agreement in Clause 11.1 was not incomplete or uncertain. The four-week provision in Clause 11.1 avoided the difficulty of having to imply a term as to the obligatory negotiation period. Further, an obligation to seek to resolve a dispute by friendly discussion imported a duty to do so in good faith. The obligation had an identifiable standard: that of a fair, honest and genuine discussion aimed at resolving a dispute.

The judge ruled that, in the context of a dispute resolution clause pursuant to which the parties had voluntarily accepted a restriction on their freedom not to negotiate, an obligation to negotiate was not inconsistent with the position of a negotiating party. Enforcement of such a dispute resolution clause was in the public interest – first, because commercial parties expected the court to enforce the obligations which they had freely undertaken, and second, because the object of the agreement was to avoid what might otherwise be an expensive and time-consuming arbitration.

Did the parties comply with Clause 11.1?

The final issue for the judge's decision was whether the parties had in fact complied with Clause 11.1. He found that they had done so. Friendly discussions had taken place in December 2009 and again in February and March 2010 at a time when Emirates was aware of Prime's claim for liquidated damages. Prime did not refer its claim to arbitration until June 2010. More than four continuous weeks had elapsed since the meetings in December and – insofar as it was relevant – since the meetings in February and March 2010.

The judge concluded that the arbitral tribunal had jurisdiction to decide the dispute between Emirates and Prime. The condition precedent, although enforceable, had been satisfied.

Comment

The ruling in *Emirates* marks a departure from previous decisions on agreements to negotiate in the context of dispute resolution clauses. It remains to be seen whether and to what extent the decision will be followed in the future.

Much will depend on the circumstances of the particular case. For example, in *Emirates*, the judge held that the duty to negotiate was an enforceable condition precedent to commencing arbitration, indicating that if it had not been satisfied, the arbitral tribunal would not have had jurisdiction to hear Prime's claim. In other cases – in particular those falling outside the framework of a jurisdictional challenge under the Arbitration Act 1996 – a failure to comply with a contractual duty to negotiate may give rise to a claim for nominal damages only, rather than constituting a bar to commencing formal proceedings; or the clause may continue to be held too uncertain to enforce.

A recalcitrant party will likely seek to rely on decisions such as *Emirates* to delay the commencement of formal proceedings by arguing that the condition precedent to those proceedings has not yet been satisfied.

If parties wish to include a duty to negotiate in their dispute resolution clause, they should ensure that it is clearly drafted and includes a time limit. If the wording of the clause is not absolutely clear, uncertainty regarding the scope and enforceability of the duty to negotiate can result in further disagreement and additional cost and delay – the very issues that a contractual duty to negotiate is intended to reduce.

For further information on this topic please contact [Marie Berard](mailto:marie.berard@cliffordchance.com) or [Katharina Lewis](mailto:katharina.lewis@cliffordchance.com) at Clifford Chance LLP by telephone (+44 20 7006 1000), fax (+44 20 7006 5555) or email (marie.berard@cliffordchance.com or katharina.lewis@cliffordchance.com). The Clifford Chance website can be accessed at www.cliffordchance.com.

Endnotes

(1) [2014] EWHC 2104 (Comm).

(2) [1992] AC 128.

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