Chapter 1[1]
PRECONTRACTUAL LIABILITIES AND AGREEMENTS IN ENGLAND AND WALES

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I. Introduction

Most commercial contracts and agreements, from a simple sale and purchase contract to a complex joint venture agreement, are the product of a series of negotiations. These negotiations can be detailed and lengthy. If they do not conclude as the parties had hoped, one or other of them may have unfulfilled expectations or, worse still, feel that they have been treated unfairly. Often in such circumstances the parties will seek legal advice as to whether there is anything that can be done to redress their grievance.

One often hears clients say "but we agreed this" or in negotiations one party will say to the other "this was agreed some time ago", or "this was agreed in the MOU". However, from a legal point of view, things are not so straightforward. In analysing the facts, the approach of the English lawyer and that of his client will be quite different, the latter will be interested

[1] This book in general and this Chapter specifically deal with general legal issues. We do not delve into the fiscal considerations. However, the tax and financial considerations of agreements may be complex and should never be overlooked.

in what led to the break in negotiations whereas the former will look at the negotiations and try to assess whether they gave rise to any liability.

Whilst there is no single clear article of law or statement of what liability may attach to a party that has engaged in negotiations and failed to conclude them, the common law lawyer has at his disposal a number of tools.

He will first seek to establish whether a legally binding and enforceable contract exists and, if it does, what its terms are. In other words have the parties "struck a deal?" If it does not exist, he will look to establish whether the parties, by design or accident, have created any enforceable rights or obligations, contractually or otherwise. In most cases any remedies that are then available to the client will arise in tort and not in contract.

II. What is the Legal Effect of Negotiation?

The businessman recognises that all negotiations are a series of steps, these steps can be lengthy or they can be quick and easy. He probably does not necessarily understand that once the very first of these steps has been taken he may have entered into a relationship that gives rise to obligations, rights and liabilities.

Common law contract law principles, as has already been said, have traditionally upheld and protected the freedom to do business as dictated by the market and not by legislators. It is unashamedly a merchants' legal system, very much based on the law being kept away from meddling in the job of the businessman and only stepping in where a problem arises. It is not the role of the common law to prevent a problem arising it the first place.

Over time, these principles have, of course, developed from simply looking to see whether a binding contract exists and now include ensuring that the parties have acted in what the law considers to be an acceptable manner, regardless of whether or not a fully-fledged contract is ever concluded.

III. Ground Rules: Good Faith and Bad Faith

A. Good Faith Obligation

Civil jurisdictions through their various codes and general legal theories, seek to prevent rather than cure and there is invariably an overriding

obligation on how parties are expected to behave towards one another. Often enshrined in the relevant Civil Code, the good faith obligation generally requires parties negotiating, performing and enforcing contracts[2] to follow rules of behaviour in a way that a common law lawyer would see as a limit on the parties' freedom to negotiate and subsequently to perform their obligations.

In stark contrast, English law imposes no general duty, either in respect of the performance or enforcement of a contract or in the process that leads to the conclusion of an agreement.

English law, starts from the premise that it is for the market to set the parameters of behaviour generally to be expected of business people. It follows, therefore, that the businessman must be in a position to act in his own self-interest, as he sees fit, even if this is at the expense of the interest of the party with whom he is negotiating.

This position is tempered by various rules affecting fair competition, consumer protection[3] and rules about reasonableness in contract terms[4]. In general, however, parties negotiating as equals are considered by the law to be able and capable of looking after themselves.

Whilst staying true to its general principles, English common law has nevertheless recognised that whilst the parties must look after themselves[5] it is fundamental to ensure that their dealings are undertaken honestly. It is important to note here that honesty does not mean fairly, it simply means truthfully.

It follows therefore, that implied duties of good faith, so common in other jurisdictions, are limited, if they exist at all, to situations where one party owes a specific **duty of care** (a **fiduciary duty**) to the other[6].

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[2] See for example the German Civil Code, Article 242; the Italian Civil Code Article 1175; the Greek Civil Code Article 288; and the Dutch Civil Code Article 6:2.

[3] The rules regarding consumer contracts and consumer protection generally are not the subject of this work, but they are extensive and should be considered by anyone seeking to establish contracts with consumers.

[4] Although the Unfair Contract Terms Act 1979 excludes application to international contracts (Section 26), there are still common law rules which apply.

[5] Caveat emptor being the prime example.

[6] These are known as contracts of ubermiae fidei such as insurance contracts to those situations where the contract creates a relationship that is confidential or fiduciary (e.g. as between lawyer and client).

The English lawyer's dislike of good faith is best summed up by the leading case on this issue[7]. The case involved the sale of a business and a dispute about the enforceability of a purported exclusivity agreement and obligation to negotiate in good faith.

Lord Ackner in his judgment asked, "…How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations?" and went on to say that, "…the concept of a duty of good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations"[8]. Whilst the decision has been criticised, it still stands as the leading case on the matter.

The obligation is unenforceable for two basic reasons: first that it is uncertain, and secondly that it is a fundamental rule of English law that the law should not accept fetters on a party's ability to act in its own interests[9].

There are, however, a number of cases where the courts have tried to distinguish the facts from the established rule to find that in certain circumstances an obligation to act in good faith might be enforceable[10]. Essentially, these cases indicate that a good faith obligation which is contained in an otherwise enforceable agreement, that is set out expressly and where the conduct of the parties can be assessed by a third party to have or not to have been undertaken in good faith (in practice probably the most difficult matter upon which to take a view), may be enforceable.

However, the position is not clear and the only House of Lords decision[11] says that such obligations are not enforceable. This leaves the matter open to conjecture and is therefore dangerous both for the party wishing to rely on the obligation and the party that does not. Any agreement where the parties make reference to an obligation to be performed in good faith needs to be carefully considered and if possible alternative wording should be used to specify exactly what the parties expect of one another.

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[7] See Walford v Miles [1992] 2 AC 128.

[8] See Walford v Miles ([1992] 2 AC 128 Lord Akner.

[9] See Walford v Miles [1992] 2 AC 128; and Courtney & Fairbairn v Tolaini Brothers (Hotels) Ltd and Another [1975] 1 WLR 297.

[10] See Cable & Wireless Plc v IBM United Kingdom Ltd [2002] EWHC 2059 (Comm); Petromec Inc. v Petroleo Brasileiro SA [2005] EWCA Civ 891; and Butters & Ors v BBC Worldwide Ltd & Ors [2009] EWHC 1954.

[11] See Walford v Miles [1992] 2 AC 128.

In a case which revolved around whether parties had an obligation to bring certain matters to the attention of the other, akin to a duty of good faith as recognised by a civil lawyer, Bingham LJ sets the scene for the current legal thinking, "In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as 'playing fair', 'coming clean' or 'putting one's cards face upwards on the table.' It is in essence a principle of fair open dealing…English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness"[12].

B. Obligation to Act Reasonably or Fairly

Whilst not recognising good faith per se, English law may impose obligations to act "reasonably" or "fairly". These obligations can be implied by the courts into the parties' arrangements where the court feels that it is appropriate to do so. In so doing the court will consider the intentions of the parties and seek to give effect to the commercial realities of the contract. The obligation will be construed by the court objectively, making the reasonableness of the parties' actions something that may be widely interpreted.

C. What is Good Faith?

The good faith issue has not however, gone away. In 2010, an interesting case came before the High Court involving the development of Chelsea Barracks in central London[13].

The case concerned the sale of an interest in a joint venture company that was set up to redevelop the Barracks. The interest was sold before

[12] See Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989] 1 QB 433 439.

[13] See CPC Group Limited v Qatari Diar Real Estate Investment Company [2010] EWHC 1535.

planning permission was obtained, but the deal struck by the parties was that they would both benefit from the future redevelopment if planning permission were to be obtained (in effect the obtaining of the permission gave rise to a substantial adjustment in the purchase price). The contract contained a specific provision whereby the parties declared that they owed one another a duty of "utmost good faith".

After the sale of the interest in the company, the Qatari buyer was informed that HRH the Prince of Wales personally disapproved of the redevelopment. As a result of this information the planning application was withdrawn. The CPC Group sued the Qatari's for a failure to pursue the application arguing, amongst other points, that this was a breach of their duty of "utmost good faith" towards CPC.

The case was decided in the High Court. The judge, Vos J, said that in his view the good faith obligation amounted to an enforceable obligation to act reasonably in the circumstances. However, that this obligation did not (even in this case where the parties had used the word "utmost") amount necessarily to an obligation that the parties could not act in their own best interests.

In the case, the judge went on to look at case law that had, in the past, tried to define what an obligation to act in good faith might actually amount to. He agreed with previous decisions[14] that an obligation to act in good faith was in effect a negative obligation not to act in bad faith, "…the concept of good faith should not be diluted by treating it as capable of being breached by conduct that is not dishonest or otherwise tainted by bad faith….In my judgment, the breach of a duty of good faith should … require some dishonesty or improper motive, some element of bad faith, to be established"[15].

D. What is Bad Faith?

The same principle was expressed by Lord Scott giving judgment in the Manifest Shipping case, "...unless the [defendant] has acted in bad faith he cannot, in my opinion, be in breach of a duty of good faith, utmost or otherwise"[16].

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[14] See Medforth v Blake [2000] Ch. 86; Manifest Shipping Co v Uni-Polaris Shipping Co [2003] 1 AC.

[15] See Medforth v Blake ([2000] Ch. 86 Sir Richard Scott, Vice Chancellor.

[16] See Manifest Shipping Co v Uni-Polaris Shipping Co [2003] 1 AC 469.

The issue is, therefore, what constitutes "bad faith"? For an English lawyer, bad faith is not simply the opposite of good faith as a civil lawyer might understand it.

A good example here is perhaps that there is no general obligation in English law that requires disclosure of pertinent facts or to correct apparent mistakes in the understanding of the parties. Not making such disclosures may seem like bad faith to a civil lawyer, but not to an English one. Though in some extreme cases this could amount to a **misrepresentation**[17].

For an English lawyer, bad faith implies some wrongdoing that goes beyond a moral obligation. Again the Chelsea Barracks case helps us understand current thinking. The judge made useful references to a decision of Longmore LJ in which he said that, "in the absence of fraud it would be unlikely that there would be a finding of bad faith"[18].

Thus the legal effect of the good faith provision is negligible, since it does not impose any substantive duty or obligation, other than not to act dishonestly, in relation to the matters at hand.

The courts rely mainly on equitable principles to ensure fairness, striking against unconscionable conduct and bad faith both during negotiations and afterwards in contract performance.

Perhaps one of the most striking examples of this principle is, indeed, the maxim **caveat emptor** (buyer beware). Established in 1603[19], the doctrine establishes, in essence, that it is for the buyer and not the law, to ensure that he understands the deal he is making, that he has all the relevant facts regarding what he is buying and that he is getting the bargain he wants.

E. Express Duty to Negotiate in Good Faith

Sometimes contracts and indeed preliminary agreements include an express duty to negotiate in good faith. The approach of the courts varies as to the enforceability of such an obligation; however, there is some

[17] See this Chapter, Section IV Remedies and Liabilities, B. Misrepresentation and Misstatement.

[18] See Petromec Inc. v Petroleo Brasilero SA Petrobras (No.3) [2005] EWCA Civ 891.

[19] See Chandelor v Lopus [1603] Cro Jac 4.

suggestion, albeit reluctantly, that it may be enforceable if it forms part of an otherwise enforceable, more complex contract[20].

Even where the duty is recognised, the courts will be reluctant to give it any significant meaning, "...good faith, whilst requiring the parties to act in a way that will allow both parties to enjoy the anticipated benefits of the contract, does not require either party to give up a freely negotiated financial advantage clearly embedded in the contract"[21].

It seems clear however, that the duty must be express and that it cannot be implied[22].

There are, as a result of statutory intervention, specific circumstances in which these general rules do not apply (such as insurance contracts where parties are required to be of utmost good faith with one another), but in most contractual scenarios, it is each man for himself.

IV. Remedies and Liabilities

We have said that English common law recognises the importance of the freedom to negotiate in business life but also that there is a need for effective control of abuse. The law deals with it in two ways. First, the courts will go to great lengths to find that a contract exists and secondly, where this is not possible, the courts have come up with a series of remedies available to the injured party through which he can seek redress against an unscrupulous counterparty.

These remedies take two distinct forms. Where a contract has been concluded the courts can grant relief to an innocent party either by awarding **damages** (i.e. compensating the party for loss) or by allowing it to rescind the contract, putting the parties back in their original positions (i.e. before the contract was entered into) and releasing them from the obligations undertaken. Where no contract was entered into, but obligations have been created, then the remedies are tortious ones, based on

[20] See Berkeley Community Villages Ltd and another v F Pullen and others [2007] EWCH 1330 (Ch); and Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest) [2013] EWCA Civ 200.

[21] See Gold Group Properties Ltd v BDW Trading Ltd [2010] EWHC 1632 (TCC).

[22] See TSG Building Services plc v South Anglia Housing Ltd [2013] EWHC 1151 (TCC).