In Practice

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Agreements to negotiate in good faith: the end of the line?

This article considers whether agreements to negotiate in good faith can be distinguished from agreements which are uncertain in their terms and whether both are equally unenforceable.

It is considered trite law that an agreement to agree will be unenforceable under English law[1]. Certain *obiter* comments made in the 2005 *Petromec*[2] case by the Court of Appeal, however, raised concerns amongst lenders about the non-binding nature of various letters and other documents which are regularly used in finance transactions. The Court of Appeal comments suggested that courts would be reticent to find that an agreement to negotiate in good faith which was drafted by lawyers would have no legal substance.

Fears of a shift towards a continental-style approach to agreements to negotiate have been partly allayed by the High Court's recent decision in *Barbudev v Eurocom Cable Management Bulgaria EOOD & Ors*[3].

THE FACTS

In 2005, Mr Barbudev commenced negotiations with the Warburg Pincus Group (Warburg) for the merger of his company, Eurocom Plovdiv EOOD, with Warburg's existing Bulgarian cable business.

Early on, it was agreed that Mr Barbudev would have the opportunity to purchase 10% of the merged entity and maintain a management role. The bone of contention was the amount which Mr Barbudev was to pay for this stake. With no resolution on this point reached prior to the signing of the Sale and Purchase Agreement (SPA), the parties attempted to break the impasse by making entry into an Investment and Shareholders Agreement (ISA) a condition precedent to closing, although the SPA allowed either party to waive this condition.

In order to provide comfort to Mr Barbudev, Warburg wrote him a side letter (the Side Letter) agreeing to offer him the opportunity to invest in the merged entity on terms to be agreed in the ISA. The Side Letter provided that Warburg would, "negotiate the [ISA] in good faith with [Mr Barbudev]," and set out its key terms, namely that Mr Barbudev would invest not less than €1.65m in consideration for a combination of shareholder debt and registered shares representing 10% of the registered share capital of the merged entity. The Side Letter also contained typical boiler plate provisions. In the event, the transaction closed with no agreement reached, Mr Barbudev was not given an opportunity to invest in the business and he sought to rely on the Side Letter as an enforceable contract.

THE DECISION

Counsel for Mr Barbudev suggested that the Side Letter was clearly intended to be binding on the parties, and a reasonable businessman would have thought this to be the case. He also submitted that there was no uncertainty as to the "key terms" of the agreement, such that the court could enforce the contract by allowing Mr Barbudev to purchase 10% of the merged entity in exchange for €1.65m.

In contrast, Counsel for Warburg submitted that the Side Letter was unenforceable on three grounds: (i) the parties lacked any intention to create legal relations; (ii) the Side Letter was unenforceable as an agreement to agree; and (iii) it was not a sufficiently complete and certain contract.

As to whether there was intention to create legal relations, Mr Justice Blair considered this question to be dependent upon the answer to the latter two arguments, as there can be no intention to create legal relations if the agreement is unenforceable in its entirety.

Considering whether an agreement to negotiate in good faith was to be distinguished from an agreement to agree, Mr Justice Blair concluded that no distinction was to be made between the two, so that an agreement to negotiate in good faith was equally unenforceable. In reaching this decision he placed some weight on his finding that the "key terms" of the agreement had not in fact been fixed, for example, the amount payable by Mr Barbudev was only stated as, *"not less* than €1.65m". Although he conceded that the parties had agreed in principle, the judge held that this was not sufficient to create a binding agreement.

Mr Justice Blair also disagreed with the submission that were the key terms taken as agreed, there was enough "set in stone" to allow the courts to enforce the agreement. In order for an agreement to be enforceable, there must be sufficiently complete and certain agreement on all eventual terms, which was not the case here.

Consequently, Mr Justice Blair held that the Side Letter did not constitute a legally enforceable contract.

COMMENT

Although a lower court decision, this ruling should remove much of the uncertainty surrounding the enforceability of an agreement to negotiate in good faith. It is clear that if parties progress with a transaction where key terms are outstanding on a promise that they will be negotiated later, this promise will not be legally enforceable.

If a side letter is to be binding, it must function as a freestanding contract by complying with the ordinary principles of contract law. As such, agreements to negotiate in good faith and agreements which are uncertain in their terms will not be enforceable. ■

1 *Walford v Miles* [1992] 2 AC 128.

2 *Petromec Inc, Petro-Deep Inc, Societa Armamento Navi Appoggio SpA v Petroleo Brasileiro SA Petrobras, Braspetro Oil Services Company, Den Norske Bank ASA* [2005] EWCA Civ 891.

3 *Georgi Velichkov Barbudev v Eurocom Cable Management Bulgaria Eood, Warburg Pincus International LLC, F.N. Cable Holdings BV* [2011] EWHC 1560 (Comm).

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