Choice-of-Law Considerations in Transatlantic Transactions

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Originally published in the New York Law Journal, May 2017

When parties are negotiating an agreement or exchanging term sheets that will form the basis for a more formalized agreement, there is no shortage of business and economic issues to consider, especially when the proposed transaction involves parties across the Atlantic. The parties, however, should be aware that there are subtle differences between the approaches of New York and English law as to whether the courts will step in to "complete" preliminary or incomplete agreements where material terms are left to be agreed. One such difference is whether a preliminary agreement creates a duty to negotiate any remaining open terms in good faith.

Under both New York and English law, where parties contemplate further negotiations of open terms and/or the execution of a formal written agreement, a preliminary agreement ordinarily does not create binding obligations.See Gas Natural v. Iberdrola, S.A. , 33 F. Supp. 3d 373, 378 (S.D.N.Y. 2014); *Barbudev v. Eurocom Cable Management Bulgaria Eood* [2012] EWCA Civ. 548. In certain circumstances, however, both New York and English courts may enforce these agreements where doing so would be consistent with the parties' intent.

When deciding whether a preliminary agreement is enforceable, both English and New York courts first ask the same basic question, which is whether the words used, and the background circumstances show, there is an intention to create binding legal relations. If so, courts will "strive" to give effect to that intention.See Point Developers v. F.D.I.C. , 921 F. Supp. 1014, 1022 (E.D.N.Y. 1996); *Interoil LNG Holdings v. Merrill Lynch PNG LNG , 60 A.D.3d 403, 404* (1st Dep't 2009); Chadwick LJJ. in *BJ Aviation v. Pool Aviation* [2002] EWCA Civ. 163, paragraphs 20 and 23; Eder J. in *MRI Trading AG v. Erdenet Mining Corporation* [2012] EWHC 1988 (Comm), paragraph 27; *Mamidoil-Jetoil Greek Petroleum Company SA v. Okta Crude Oil Refinery Ad* [2001] EWCA Civ. 406, paragraph 69.

Under English law, a list of relevant factors indicating an intention to create binding legal relations is set out in case law (summarized by Eder J. in *MRI Trading AG v. Erdenet Mining* [2012] EWHC 1988 (Comm) in paragraph 23 and Chadwick LJJ. in *BJ Aviation v. Pool Aviation* [2002] EWCA Civ. 163 in paragraphs 18 to 24). That list is not closed and each case will be decided on its own facts and contractual language. The relevant criteria includes the nature of the language used, whether essential terms are still left to be agreed, whether parties have acted in the belief they have a binding contract, and whether there has already been part performance of the contract that has left terms to be determined in the future. Contractual choice of arbitration for resolution of disputes is also taken as a sign that the parties intend their incomplete agreements to be binding.

The way in which English courts will "strive" to give effect to the parties' intention is by implying a term using objective criteria.See Chadwick LJJ. in *BJ Aviation v. Pool Aviation* [2002] EWCA Civ. 163, as summarized in paragraphs 18 to 24. For example, a price, rent, or delivery schedule may be construed as a "reasonable" or "market" price, rent, or delivery schedule. English courts have statutory authority to do so in certain circumstances in cases of sales of goods or services.See, e.g., Sale of Goods Act 1979 §8(2), where, if the price for the purchase of goods in a contract covered by the Act is not fixed, or is left to be fixed in a manner agreed by the contract or by a course of dealing between the parties, the buyer must pay a reasonable price.

By way of example, in *MRI Trading AG v. Erdenet Mining* [2012] EWHC 1988 (Comm), the High Court and the Court of Appeal both held in favor of overturning an arbitration award that found a contract for a year's supply of copper concentrates to be unenforceable because it stated that the treatment and refining charge ("TC/RC"—an element of the price) and the delivery schedule "shall be agreed," but were not in fact agreed. The courts said that under the circumstances, a term could be implied and that a reasonable TC/RC and a reasonable delivery schedule should be determined in the absence of the parties' agreement.

The criteria for implying terms at English common law, however, has recently been clarified by the English Supreme Court to apply only to situations where the implication is so obvious to the reasonable reader that it goes without saying or is essential to give the agreement business or practical coherence.*Marks & Spencer v. BNP Paribas Securities Services Trust Co (Jersey)* [2015] UKSC 72. As part of this analysis, the court considered whether the implied term put forward was inconsistent with other express terms in the agreement. Therefore, even in circumstances where an English court finds that there is an intention to create binding legal relations, it may still not be able to imply a term, despite striving to do so. A recent example of this is the *Teekay Tankers v. STX Offshore & Shipbuilding* decision by the High Court.[2017] EWHC 253 (Comm). In that case, the court refused to imply a term requiring "reasonable" delivery schedules in an option agreement for additional vessel deliveries by a shipyard and for the yard to use "best efforts" to deliver within certain periods. The court held that because both parties could have regard to their own self-interests in selecting a delivery date, there was no practicable way to imply a single objectively reasonable measure to fill the gap.

Similarly, New York courts strive to enforce the clear intention of the parties to enter into an agreement and have recognized two situations where an agreement is enforceable even where it is missing an explicit contract term. First, under New York law, an agreement is enforceable when it contains a "methodology" for determining the missing terms within the agreement. See *Point Developers*, 921 F. Supp. at 1022. Second, an agreement that "invite[s] recourse" to extrinsic evidence that would supply the missing terms is enforceable.See id.; see also Oquendo v. CCC Terek , 111 F. Supp. 3d 389, 413 (S.D.N.Y. 2015) (finding contract that was missing a price term was enforceable because the missing term could be established by industry custom and practice).

For example, in *Interoil LNG Holdings v. Merrill Lynch PNG*,60 A.D.3d 403 (1st Dep't 2009), New York's Appellate Division found that a supply contract, which did not include price terms, was not impermissibly vague to be unenforceable. Instead, the court found that "[w]hile the price term in [the] agreement is not definite on its face … defendant has made a sufficient showing that the term can be supplied from public price indices and industry practice."Id. at 404. Accordingly, the *Interoil* court held that the agreement was not too vague to be enforced because the language in the agreement demonstrated the parties' clear intent to enter into a contract. Id. By contrast, a New York court found an agreement unenforceable when a price term is not included in a contract and the precise determination of the missing price term was left to a future "formula yet to be developed."See *Alter v. Bogoricin*, No. 97-CIV-0662(MBM), 1997 WL 691332, *7 (S.D.N.Y. Nov. 6, 1997). There, the Southern District court found that the language of the agreement made plain that the parties' intention was to have future negotiations regarding the missing price term. Id.

Where New York and English law differ is whether an agreement to agree creates an independent duty to negotiate open terms in good faith. English courts, generally, will not imply obligations to negotiate in good faith as these obligations are normally not enforceable.*Walford v. Miles* [1992] 2 W.L.R. 174. See Rix LJ in *ING Bank*

N.V. v. Ros Roca SA [2011] EWCA Civ. 353. Under New York law, however, parties who have a preliminary written agreement may be bound to negotiate in good faith towards a final agreement.

For example, according to the Second Circuit, where parties have agreed in writing on certain major terms, but leave other terms open for future negotiation, the parties are not bound to the obligations agreed to in the preliminary agreement. Rather, under New York law, the parties are obligated to negotiate the remaining terms in good faith. See *Gas Natural*, 33 F. Supp. 3d at 379; *L-7 Designs v. Old Navy , 647 F.3d 419* (2d Cir. 2011).

New York courts impose a duty to negotiate in good faith so that parties who have spent time and resources negotiating the terms of an agreement can have assurances that the transaction will falter, if at all, only over a genuine disagreement regarding the remaining open terms. This assurance allows a party who is short on time or money to prepare to perform under the as-yet finalized agreement with a sufficient degree of confidence that the agreement will indeed be finalized. The requirement to negotiate in good faith, however, does not require that the agreement be finalized, as a party may abandon the transaction as long as it has made a good faith effort to close the deal and has not insisted on terms that are inconsistent with the preliminary agreement.See *Gas Natural*, 33 F. Supp. 3d at 382. Furthermore, a plaintiff's damages for a breach of good faith may be limited to out-of-pocket costs incurred in the course of good faith partial performance.See Arcadian Phosphates v. Arcadian , 884 F.2d 69, 74 n.2 (2d Cir. 1989). Lost profits or the benefit of the bargain that never came to pass are not available to a plaintiff where no agreement is reached.See *L-7 Designs*, 647 F.3d at 431.

Generally, negotiating in good faith requires each party to be honest about their respective interests, positions, or understandings.*Penguin Grp. (USA) v. Steinbeck*, 06-CV-2438 (GBD), 2009 WL 857466, at *2 (S.D.N.Y. March 31, 2009). Acting in one's own self-interest, however, does not constitute bad faith.See L-7 Designs v. Old Navy , 964 F. Supp. 2d 299, 307 (S.D.N.Y. 2013). Bad faith in this context requires a deliberate, malevolent attempt to back out of the deal.

In practice, New York courts struggle to balance enforcing agreements or terms that were intended to be binding with the risk of trapping parties in surprise obligations that they never intended. For example, in *Gas Natural v. Iberdrola, S.A.*,33. F. Supp. 3d 373 (S.D.N.Y. 2014), the court found that the defendant did not breach its duty to negotiate in good faith where the defendant ended negotiations with the plaintiff because the defendant found another purchaser. The *Gas Natural* court found that because the parties discussed exclusivity, but did not include an exclusivity clause in the preliminary agreement, requiring exclusivity would trap the defendant in a contractual obligation that it never intended. In contrast, New York courts have found that a party breaches its duty to negotiate in good faith where a party attempts to back out of a deal for non-commercial reasons, by altering the terms on which the parties have already reached agreement.See, e.g., EQT Infrastructure v. Smith , 861 F. Supp. 2d 220, 231 (S.D.N.Y. 2012); *Teachers Ins. & Annuity Ass'n of Am. v. Ormesa Geothermal , 791 F. Supp. 401, 415* (S.D.N.Y. 1991)

In English law, enforcement of express good faith obligations in terms of negotiations have been limited to the enforcement of procedural or contractual requirements such as those that expressly require parties to try to resolve a dispute by "friendly negotiations" as a precondition to resorting to arbitration,*Emirates Trading v. Prime Metal Exports Private* [2014] EWHC 2014 (Comm), or to enforcing "lock out" provisions in negotiations providing they are certain as to duration.*Pitt v. PHH Asset Management Ltd* [1994] 1 W.L.R. 327. It is also thought that the same English law principles that restrict the implication of terms into a contract will have a limiting effect on the development of an obligation of good faith in negotiations.Chitty on Contracts, 32nd Edition, Volume 1 at 1-053. In some limited circumstances, however, English tort law may provide remedies for bad faith or misrepresentation during negotiations, which rise to the level of independent torts.

In conclusion, the finding of an objective intention to create legal relations and then striving to find enforceable terms is a common approach in the two legal systems. In these circumstances, extrinsic objective criteria for implication of reasonableness terms are important. New York law may have an extra stick in terms of imposing

good faith obligations to negotiate, although in many cases compensation for wasted expenses will only be small consolation for a lost deal.

There is often a very good commercial reason for not wanting to agree on future obligations on day one of an agreement. In many cases, future prices can simply not be foreseen. Stable long term business relationships can help to provide comfort and trust that matters to be agreed, shall in the end, be agreed. However, friendships don't necessarily last forever and the prudent advice would always be to try and draft the agreement to provide express deadlock breakers like references to expert determination or other objective criteria, which can be used to bridge any gaps in the event of disagreement. An old Russian proverb comes to mind: "Trust, but verify."

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