BEFORE LORD KEITH OF KINKELL, LORD ACKNER, LORD GOFF OF CHIEVELEY, LORD JAUNCEY OF TULLICHETTLE AND LORD BROWNE-WILKINSON : HOUSE OF LORDS : 23rd January 1992

LORD KEITH OF KINKEL.

My Lords, I have had the opportunity of considering in draft the speech to be delivered by my noble and learned friend Lord Ackner. I agree with it, and for the reasons he gives would dismiss this appeal.

LORD ACKNER.

My Lords, Mr Martin Walford, the first named appellant, is a solicitor in private practice. He is the brother of the second named appellant, Mr Charles Walford**,** who is a chartered accountant. They own the third named plaintiff, a company which plays no part in this dispute. The respondents, Mr and Mrs Miles, husband and wife, at the material time owned a company, PNM Laboratories Ltd, together with premises in Blackfriars Road, London, which was let to the company, where it carried on a photographic processing business. The company's auditors at the material time were Mr Patel and Mr Khanderia, who carried on their profession under the name of Patel Khanderia & Co.

In 1985, because of illness, Mr Miles decided to sell the company and its business premises. Negotiations took place with Mr Patel and Mr Khanderia via the medium of a company, Statusguard Ltd, in which Mr Patel and Mr Khanderia had a 30% interest. These negotiations proved unsuccessful.

Towards the end of 1986 the respondents decided once more to try to sell the company and its business premises. Mr Patel put forward an offer of £1.9m. Meanwhile the appellants had heard that the business was up for sale. There was a meeting between Mr Martin Walford and Mr Miles on 23 April 1987. Although the appellants knew nothing about the photographic processing business, they thought they had found a bargain. The respondents were prepared to warrant that at the date of completion the cash resources in the company's bank account would not be less than £1m and that the trading profits for the 12 months following completion would not be less than £300,000 before tax. The appellants considered that the business and its premises were, in the words of Mr Naughton QC in opening this appeal, 'dramatically undervalued'. They were accordingly enthusiastic to purchase it at this price.

Following a meeting on 12 March 1987 at Mr Martin Walford's offices, the main terms of the purchase were agreed in principle and on 16 March Mr Martin Walford faxed a letter expressly headed 'subject to contract' to Mr Randall of Messrs Tarlo Lyons Randall Rose, the solicitor for the respondents. The purchasers were not to be the Walfords but a company controlled by them (the third named appellant). In his letter of 16 March Mr Martin Walford recorded that Mr Miles had given his assurance that, provided he received a clear indication of the intention to proceed with the purchase not later than the close of business on Wednesday, 25 March, he would not treat with any third party or consider any other alternative offers. Mr Randall replied on 17 March that he did not have any instructions to proceed with the sale and that Mr Miles had not given the assurance alleged. This letter was however overtaken by oral exchanges which occurred on the same day between Mr Martin Walford and Mr Miles**.** On 18 March Mr Martin Walford wrote to Mr Randall confirming what had been agreed during that telephone conversation. It is common ground that the penultimate paragraph of that letter correctly sets out the agreement which had been reached as to negotiations between third parties. It reads as follows:

'The last matter discussed between Mr Miles and me related to our ability to make payment for the shares in the business and the property. He asked me to provide a comfort letter from our bankers confirming that they are, subject to contract, prepared to provide the finance of £2,000,000 to enable Acquisition Corpn to effect the purchase. Mr Miles agreed that if such a letter were in your hands by close of business on Friday of this week he would terminate negotiations with any third party or consideration of any alternative with a view to concluding agreements with me and my brother and Acquisition Corpn and he further agreed that even if he received a satisfactory proposal from any third party before close of business of Friday night he would not deal with that third party and nor would he give further consideration to any alternative.'

The letter from Lloyd's Bank which Mr Walford enclosed, dated 18 March, was addressed to Mr Randall and expressed to be given without responsibility. It confirmed that the bank had offered the brothers loan facilities to enable them and the company controlled by them to make the purchase for £2m.

On 25 March Mr Randall wrote to Mr Martin Walford acknowledging the receipt of this letter and enclosure, and confirmed that, subject to contract, his client agreed to the sale of the property and the shares at a total price of £2m. On the same day Mr Randall wrote to Mr Patel's solicitors informing them that his client had concluded terms for the sale of the property and the shares in the company to another party and that he was waiting to receive a draft contract. He pointed out that everything was still subject to contract and that the transaction might not go through, but that, if it did not, his client would be interested to pursue discussions. On 26 March Mr Walford'**s** solicitors sent preliminary inquiries and a draft share purchase agreement to Mr Randall, who sent them on to Mr Miles the following day. Mr Martin Walford was anxious to meet Mr Miles on that day, but Mr Miles was not available.

On 30 March Mr Randall wrote to Mr Martin Walford informing him that, after careful consideration, his clients had decided to sell to a company associated with the auditors, adding that he hoped that the appellants would accept his clients' decision without question. This they refused to do. They treated Mr Randall's letter as a repudiation of what they alleged to be a contract and then issued these proceedings. Meanwhile the shares in the company and the property in Blackfriars Road had been sold for £2m to Statusguard Ltd, the corporate vehicle through which Mr Patel and Mr Khanderia had tried to make the purchase in 1985.

Mr Miles did not give evidence before the trial judge, Judge Bates QC sitting as a judge of the High Court. It was Mrs Miles who informed the court that she and her husband spent the afternoon of Friday, 27 March at the company's premises and during that time decided not to sell to the Walfords or their company. Her explanation was that they were concerned whether they and their staff would get on well with Mr Martin Walford. If they failed to do so, they might lose staff and then fail to produce the £300,000 profit which was the subject of the warranty. Moreover, they were both concerned that her husband's health might suffer during the year that he would be continuing to work in the business, providing the Walfords with the expertise which they lacked. They therefore decided whether to continue in business themselves or to ask Mr Patel if he was still interested. There was a telephone conversation on the evening of Friday, 27 March with Mr Patel, who confirmed that he was still interested and agreed readily to increase his offer by £100,000, thus matching the price which the Walfords had offered. Mr Patel, in his evidence, said that after he had received Mr Randall's letter of 25 March he had no contact with Mr Miles until the telephone conversation on 27 March, to which I have just referred. The trial judge did not believe him. He concluded that Mr Miles and Mr Patel had continued to keep in touch, notwithstanding the oral agreement of 17 March recorded in the letter of 18 March.

The pleaded case

The appellants relied upon an oral agreement, collateral to the negotiations which were proceeding to purchase the company and the land it occupied 'subject to contract'. The consideration for this oral agreement was twofold: firstly, the appellants agreeing to continue the negotiations and not to withdraw and, secondly, their providing the comfort letter from their bankers in the terms requested.

For this consideration it was alleged in para 5 of the statement of claim as follows: *'… the [first respondent] on behalf of himself and the [second respondent] would terminate negotiations with any Third Party or consideration of any alternative with a view to concluding an agreement with the [appellants] and further that even if he received a satisfactory proposal from any Third Party prior to the close of business on 20th March 1987, he would not deal with that Third Party or give further consideration to any alternative.'*

As thus pleaded, the agreement purported to be what is known as a 'lock-out' agreement, providing the appellants with an exclusive opportunity to try and come to terms with the respondents, but without expressly providing any duration for such an opportunity. For reasons which will become apparent hereafter, it was decided to amend this paragraph by the following addition:

'It was a term of the said collateral agreement necessarily to be implied to give business efficacy thereto that, so long as they continued to desire to sell the said property and shares, the [first respondent] on behalf of himself and the [second respondent] would continue to negotiate in good faith with the [appellants].'

Thus the statement of claim alleged that, not only were the respondents 'locked out' for some unspecified time from dealing with any third party, but were 'locked in' to dealing with the appellants, also for an unspecified period.

In the statement of claim it was further alleged that, by reason of the wrongful repudiation by the respondents, the appellants lost the opportunity of completing the sale and purchase of the shares and property, and that the true market value of the shares and the property was of the order of £3m. Accordingly, the appellants claimed that they lost the difference between the price which they had agreed to pay of £2m and the true market value. In addition to the above, there was a claim for damages for misrepresentation by the respondents in continuing to deal with third parties. This consisted of the expenses incurred in the negotiations and in the preparation of contract documents.

The decision of first instance and the Court of Appeal

After the close of pleadings, directions were given, inter alia, that the assessment of any damages to which the appellants might be entitled for the alleged loss of opportunity of completing the sale and purchase of the shares and property should await the determination of the issue of liability. At the trial it was contended on behalf of the respondents that the agreement alleged in para 5 of the amended statement of claim was no more than an agreement to negotiate and as such was unenforceable. The judge did not deal with this contention. He held that there was a collateral agreement whereby the respondents undertook to terminate negotiations with any third party or consideration of any alternative and that even if Mr Miles received a satisfactory proposal from any third party before the close of business on the Friday night (20 March) he would not deal with that third party or give further consideration to any alternative, and that this agreement had been repudiated by the respondents. He therefore ordered that the damages for the alleged loss of opportunity be assessed. He further held that the promises of Mr Mile**s** under the collateral agreement were misrepresentations and awarded the appellants £700 on account of special damages, being the agreed wasted expenditure.

In the Court of Appeal, by a majority (Dillon and Stocker LJJ), the appeal was allowed (save to the extent of the award of the damages for misrepresentation) on the grounds that the agreement alleged was no more than an agreement to negotiate and was therefore unenforceable. Bingham LJ, who dissented, would have held that the agreement was enforceable on the ground that it could be construed as an agreement by the respondents not to deal with any party other than the appellants and not to entertain any alternative proposal. He would have set aside the award of damages for misrepresentation on the grounds that it was not justified by the evidence or the trial judge's findings. Before your Lordships the respondents were not contesting the £700 award.

The validity of the agreement alleged in para 5 of the statement of claim as amended

The justification for the implied term in para 5 of the amended statement of claim was that, in order to give the collateral agreement 'business efficacy' Mr Miles was obliged to 'continue to negotiate in good faith'. It was submitted to the Court of Appeal and initially to your Lordships that this collateral agreement could not be made to work, unless there was a positive duty imposed upon Mr Miles to negotiate. It was of course conceded that the agreement made no specific provision for the period it was to last. It was however contended, albeit not pleaded, that the obligation to negotiate would endure for a reasonable time, and that such time was the time which was reasonably necessary to reach a binding agreement. It was however accepted that such period of time would not end when negotiations had ceased, because all such negotiations were conducted expressly under the umbrella of 'subject to contract'. The agreement alleged would thus be valueless if the alleged obligation to negotiate ended when negotiations as to the terms of the 'subject to contract' agreement had ended, since at that stage the respondents would have been entitled at their whim to refuse to sign any contract.

Apart from the absence of any term as to the duration of the collateral agreement, it contained no provision for the respondents to determine the negotiations, albeit that such a provision was essential. It was contended by Mr Naughton that a term was to be implied giving the respondents a right to determine the negotiations, but only if they had 'a proper reason'. However, in order to determine whether a given reason was a proper one, he accepted that the test was not an objective one: would a hypothetical reasonable person consider the reason a reasonable one? The test was a subjective one: did the respondents honestly believe in

the reason which they gave for the termination of the negotiations? Thus they could be quite irrational, so long as they behaved honestly.

Mr Naughton accepted that as the law now stands and has stood for approaching 20 years an agreement to negotiate is not recognised as an enforceable contract. This was first decided in terms in ***Courtney & Fairbairn Ltd v Tolaini Bros (Hotels) Ltd*** [1975] 1 All ER 716 at 720, [1975] 1 WLR 297 at 301–302, where Lord Denning MR said: *'If the law does not recognise a contract to enter into a contract (when there is a fundamental term yet to be agreed) it seems to me it cannot recognise a contract to negotiate. The reason is because it is too uncertain to have any binding force … It seems to me that a contract to negotiate, like a contract to enter into a contract, is not a contract known to the law … I think we must apply the general principle that when there is a* fundamental matter left undecided and to be the subject of negotiation, there is no contact.'

In that case Lord Denning MR rejected as not well founded (and Lord Diplock expressly concurred with this rejection) the dictum of Lord Wright in ***Hillas & Co Ltd v Arcos Ltd*** (1932) 147 LT 503 at 515, [1932] All ER Rep 494 at 505: *'There is then no bargain except to negotiate, and negotiation may be fruitless and end without any contract ensuing; yet even then, in strict theory, there is a contract (if there is good consideration) to negotiate, though in the event of repudiation by one party the damages may be nominal, unless a jury think that the opportunity to negotiate was of some appreciable value to the injured party.'*

The decision in the ***Courtney & Fairbairn Ltd*** case was followed by the Court of Appeal in ***Mallozzi v Carapelli SpA*** [1976] 1 Lloyd's Rep 407. In that case Kerr J ([1975] 1 Lloyd's Rep 229) had applied the dictum of Lord Wright in ***Hillas & Co Ltd v Arcos Ltd*** before the ***Courtney & Fairbairn Ltd*** case had been decided and held that there was an obligation on the parties at least to negotiate bona fide with a view to trying to reach an agreement. In that case a contract for the sale of grain contained a clause which provided: *'C.I.F. FREE OUT ONE SAFE PORT WEST COAST ITALY excluding Genoa. First or second port to be agreed between Sellers and Buyers on the ship passing the Straits of Gibraltar.'*

The Court of Appeal however held that it was impossible to say that the provision in the contract was legally enforceable, or that there was any legally binding obligation to negotiate.

The decision that an agreement to negotiate cannot constitute a legally enforceable contract has been followed at first instance in a number of relatively recent cases: ***Albion Sugar Co Ltd v Williams Tankers Ltd, The John S Darbyshire*** [1977] 2 Lloyd's Rep 457, ***Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana, The Scaptrade*** [1981] 2 Lloyd's Rep 425, ***Trees Ltd v Cripps*** **(1983) 267 EG 596,** ***Nile Co for Export of Agricultural Crops v H & J N Bennett (Commodities) Ltd*** [1986] 1 Lloyd's Rep 555, ***Voest Alpine Intertrading GmbH v Chevron International Oil Co Ltd*** [1987] 2 Lloyd's Rep 547 and ***Star Steamship Society v Beogradska Plovidba, The Junior K*** [1988] 2 Lloyd's Rep 583.

In the Court of Appeal and before your Lordships Mr Naughton submitted that the *Courtney & Fairbairn Ltd* and the ***Mallozzi*** cases were distinguishable from the present case, because that which was referred to negotiation with a view to agreement in those cases was an existing difference between the parties. In the present case, so it was contended, by the end of the telephone conversation on 17 March there was no existing difference. Every point that had been raised for discussion had been agreed. However this submission overlooked that what had been 'agreed' on the telephone on 17 March was 'subject to contract'. Therefore the parties were still in negotiation even in relation to those matters. Further, there were many other matters which had still to be considered and agreed.

Before your Lordships it was sought to argue that the decision in the ***Courtney & Fairbairn Ltd*** case was wrong. Although the cases in the United States did not speak with one voice your Lordships' attention was drawn to the decision of the United States Court of Appeals, Third Circuit in ***Channel Home Centers Division of Grace Retail Corp v Grossman*** (1986) 795 F 2d 291 as being 'the clearest example' of the American cases in the appellants' favour. That case raised the issue whether an agreement to negotiate in good faith, if supported by consideration, is an enforceable contract. I do not find the decision of any assistance. While accepting that an agreement to agree is not an enforceable contract, the United States Court of Appeals appears to have proceeded on the basis that an agreement to negotiate in good faith is synonymous with an agreement to use best endeavours and, as the latter is enforceable, so is the former. This appears to me, with respect, to be an unsustainable proposition. The reason why an agreement to

negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty. The same does not apply to an agreement to use best endeavours. This uncertainty is demonstrated in the instant case by the provision which it is said has to be implied in the agreement for the determination of the negotiations. How can a court be expected to decide whether, *subjectively*, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined 'in good faith'. However, the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms. Mr Naughton, of course, accepts that the agreement upon which he relies does not contain a duty to complete the negotiations. But that still leaves the vital question: how is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an 'agreement'? A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies. In my judgment, while negotiations are in existence either party is entitled to withdraw from these negotiations, at any time and for any reason. There can be thus no obligation to continue to negotiate until there is a 'proper reason' to withdraw. Accordingly, a bare agreement to negotiate has no legal content.

The validity of the agreement as originally pleaded in the statement of claim

Paragraph 5 of the statement of claim, as unamended, followed the terms of the oral agreement as recorded in the penultimate paragraph of the letter of 18 March. It alleged that for good consideration (and this certainly covered the provision by the appellants of the 'comfort letter') Mr Miles on behalf of himself and his wife agreed that they - *'would terminate negotiations with any Third Party or consideration of any alternative with a view to concluding an agreement with the [appellants] and, further, that even if he received a satisfactory proposal from any Third Party prior to the close of business on 20 March 1987, he would not deal with that Third Party or give further consideration to any alternative.'*

Despite the insistence by Mr Naughton upon the implied term pleaded in the amendment involving the obligation to negotiate, Bingham LJ, in his dissenting judgment, considered that that obligation could be severed from the agreement. He concluded that the agreement, as originally pleaded, was a valid and enforceable agreement and entitled the appellants to recover whatever damages they could establish resulted in law from its repudiation.

Before considering the basis of Bingham LJ's judgment, I believe it is helpful to make these observations about a so-called 'lock-out' agreement. There is clearly no reason in English contract law why A, for good consideration, should not achieve an enforceable agreement whereby B agrees for a specified period of time not to negotiate with anyone except A in relation to the sale of his property. There are often good commercial reasons why A should desire to obtain such an agreement from B. B's property which A contemplates purchasing may be such as to require the expenditure of not inconsiderable time and money before A is in a position to assess what he is prepared to offer for its purchase or whether he wishes to make any offer at all. A may well consider that he is not prepared to run the risk of expending such time and money unless there is a worthwhile prospect, should he desire to make an offer to purchase, of B, not only then still owning the property, but of being prepared to consider his offer. A may wish to guard against the risk that, while he is investigating the wisdom of offering to buy B's property, B may have already disposed of it or, alternatively, may be so advanced in negotiations with a third party as to be unwilling or for all practical purposes unable to negotiate with A. But I stress that this is a negative agreement—B, by agreeing not to negotiate for this fixed period with a third party, locks himself out of such negotiations. He has in no legal sense locked himself *into* negotiations with A. What A has achieved is an exclusive opportunity, for a fixed period, to try and come to terms with B, an opportunity for which he has, unless he makes his agreement under seal, to give good consideration. I therefore cannot accept Mr Naughton's proposition, which was the essential reason for his amending para 5 of the statement of claim by the addition of the implied term, that without a positive obligation on B to negotiate with A the lock-out agreement would be futile.

The agreement alleged in para 5 of the unamended statement of claim contains the essential characteristics of a basic valid lock-out agreement, save one. It does not specify for how long it is to last. Bingham LJ sought to cure this deficiency by holding that the obligation upon the respondents not to deal with other parties should continue to bind them 'for such time as is reasonable, in all the circumstances'. He said: *'… the time would end once the parties, acting in good faith, had found themselves unable to come to mutually acceptable terms … The defendants could not … bring the reasonable time to an end by procuring a bogus impasse, since that would involve a breach of the duty of reasonable good faith which parties such as these must, I think, be taken to owe to each other.'*

However, as Bingham LJ recognised, such a duty, if it existed, would indirectly impose upon the respondents a duty to negotiate in good faith. Such a duty, for the reasons which I have given above, cannot be imposed. That it should have been thought necessary to assert such a duty helps to explain the reason behind the amendment to para 5 and the insistence of Mr Naughton that without the implied term the agreement, as originally pleaded, was unworkable—unworkable because there was no way of determining for how long the respondents were locked out from negotiating with any third party.

Thus, even if, despite the way in which the Walford's case was pleaded and argued, the severance favoured by Bingham LJ was permissible, the resultant agreement suffered from the same defect (although for different reasons) as the agreement contended for in the amended statement of claim, namely that it too lacked the necessary certainty, and was thus unenforceable.

I would accordingly dismiss this appeal with costs.

LORD GOFF OF CHIEVELEY.
My Lords, I have had the advantage of reading in draft the speech of my learned and noble friend Lord Ackner. I agree with it and for the reasons he gives I, too, would dismiss this appeal with costs.

LORD JAUNCEY OF TULLICHETTLE.
My Lords, I have had the advantage of reading in draft the speech of my learned and noble friend Lord Ackner. I agree with it and for the reasons he gives I, too, would dismiss this appeal with costs.

LORD BROWNE-WILKINSON.
My Lords, I too agree with the speech of my noble and learned friend Lord Ackner and, for the reasons which he gives, would dismiss this appeal.

Appeal dismissed.

Philip Naughton QC and Angus Moon (instructed by Wedlake Bell) for the appellants.
Stanley Brodie QC and Edward Cohen (instructed by Tarlo Lyons Randall Rose) for the respondents.