Agreements to agree: Did you contract to agree or disagree?

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"Agreements to agree" are a commercial fact of life for businesses, particularly those involved in long term contracts, such as research and development agreements in the life sciences or industrial sectors, complex technology contracts, or energy and resources supply arrangements. Often, businesses will enter into an agreement on the basis of an understanding (whether express or implicit) that a further arrangement will be reached at some future time, when the commercial rationale for and prospective terms of that further agreement may have become clearer. As a result, rather than negotiating their prospective secondary agreement at the time of initial contracting, the parties merely agree that certain or all contractual terms of that agreement will be determined in the future.

In these circumstances, the original contract will often contain a provision whereby the parties indicate that they intend to reach a new agreement in the future. Sometimes these provisions set out detailed mechanisms for doing so, while other times they can be no more than a sentence or two. This approach buys the parties time to build trust, develop the products or processes that will be commercialized down the line and establish the commercial rationale for and terms of any further engagement.

However, while such agreements to agree may be commercially attractive, whether or not they are legally enforceable is another question entirely. It is one which typically arises when one party decides not to proceed with the next phase of engagement and the other claims to have suffered loss or damage as a result of that decision.

When faced with this issue, the English courts generally require certain essential elements of a contract to be agreed before they will enforce it. In fulfilling their duty to construe contracts fairly and with the parties' intentions in mind, the courts will not intervene to "make a contract" or "go outside the words" used. Consequently, agreements to agree have traditionally been held to be void for uncertainty with the result that they are typically found to be unenforceable. It is therefore crucial that businesses give careful consideration at the initial drafting stage to what is being agreed and the risk of any terms being held to be unenforceable.

In this article, following on from our earlier case update, we explore the implications of the recent Court of Appeal case of Morris v Swanton Care & Community Ltd (Morris), in which the claimant sought to rely on a contractual option allowing him to provide additional services for "such further period as shall reasonably be agreed" as the basis for a damages claim. We conclude by highlighting certain drafting points which can be learned from the judicial treatment of agreements to agree.

**Morris v Swanton Care & Community Ltd**

*Morris* concerned a sale and purchase agreement (the "SPA") relating to shares in a company. The claimant...
received roughly £16 million in initial consideration. The SPA also provided for deferred consideration through an earn-out provision relating to the claimant’s consultancy services. The SPA stated that the claimant “shall have the option” to provide his consultancy services for a period of four years from completion of the SPA and “such further period as shall reasonably be agreed” between the parties. The claimant provided his services for four years and received approximately £4 million by way of earn-out consideration, calculated according to an agreed formula in the SPA. The claimant then requested a "reasonable extension" for the provision of his services, which the defendant rejected.

The claimant issued proceedings, claiming he was entitled to a "further period of time in which to be paid" additional earn-out consideration under the SPA. The claimant highlighted in doing so that the wording used in the SPA (ie "shall have the option") was mandatory. The defendant argued that it was not obliged to give the claimant an extension as the provision was an unenforceable agreement to agree. The defendant further contended that while it was not required to act reasonably in responding to the claimant’s proposed extension, it had in any event acted reasonably in rejecting it.

At first instance, the High Court held that the claimant had an enforceable right to provide consultancy services during the initial four-year period but had no such right during any further period. The SPA obligation for the parties to agree the length of any further period was not enforceable as it was an agreement to agree not containing any "mechanism" or "objective standard" allowing the court to "reach a conclusion" as to the length of the extension.

On appeal, the Court of Appeal agreed with the High Court, noting that "for there to be any further period, there first has to be a further agreement between the parties" as this is what was agreed in the SPA. As a result, both parties were free to agree or disagree about the length of an extension, if any, without a duty to negotiate in good faith or any need to disregard their own commercial interests (provided the underlying contract did not state the contrary, which it did not).\(^3\) The term was the "very paradigm" of an unenforceable agreement to agree.

The use of the word "option", meaning a right as opposed to an obligation to provide services, did not assist the claimant as it was still too uncertain to be enforced. The Court of Appeal also held that the word "reasonably" was used to prescribe the manner in which the parties must reach an agreement, not to oblige them to agree on a reasonable period. Furthermore, the factors identified by the claimant to assist the court in its assessment of the period were all commercial factors for the parties, and not the court, to take into account in their negotiations. Accordingly, even if the term had required the parties to agree a reasonable extension, this would have still been unenforceable for lack of an objective benchmark in the SPA (or in the performance of the initial period) by which the period of the extension would be defined.

**Key Principles**

**Starting Position of the Courts**

The courts apply an objective test to determine whether a binding contract exists and, in doing so, consider (i) whether the contract is sufficiently certain to be enforceable and (ii) whether a "reasonable man" would say that the parties were in agreement and had intended to create legal relations.\(^4\)

**Exceptions**

The courts decide each case on its own facts. However, they are reluctant to hold a term void that was "intended to have legal effect", particularly if either party has benefited from part-performance or invested premised on the contract.\(^5\) A term will therefore not be unenforceable merely because it requires further agreement of the parties if the courts can resolve the uncertainty by, for example:

- Applying standards of reasonableness to the price, which was to be agreed "from time to time"\(^6\)
- Implying terms (provided they do not contradict the contract) where it was evident that the parties were familiar with the trade and had both assumed they were bound by the contract,\(^7\) and/or
- Determining that the timing for the repayment of a loan, which was subject to negotiation, did not negate the parties’ intention to be bound by the contract, due to its subsidiary importance and the fact that the loan could be repayable on demand in the absence of an agreement\(^8\)

The courts will be even more willing to uphold an agreement to agree where the contract provides a mechanism (eg
expert determination) or objective criteria (eg fairness or reasonableness) by which to resolve the uncertainty. If the specified mechanism “breaks down” or the courts conclude that the parties’ true intention, despite not expressly stated, was to settle any disagreement by way of objective criteria, then the courts may even provide new “machinery” to resolve the disagreement.

**Duty of Good Faith**

*Morris* also endorsed the principle that a duty to negotiate in good faith is “repugnant to the adversarial position of the parties” in negotiations. The duty of good faith, if imposed on commercial negotiations, would conflict with the principle of freedom of contract allowing the parties to withdraw or threaten to withdraw at any time from negotiations without their actions being policed by the courts.

**Reasonableness and Best Endeavors/Efforts**

*Morris* confirmed the principle that general standards prescribing the manner in which parties should seek to agree terms, such as using "best efforts" or "reasonable endeavors", will not render an agreement to agree enforceable. This comes as an important statement of the court's current direction of travel in this regard and is a timely reminder that each case will turn on its particular circumstances, particularly in the context of the court previously having held that an express obligation in a contract to use all reasonable endeavors to enter into an agreement with a third party was enforceable.

**Practical Points**

*Morris* is a helpful reminder that when it comes to agreements to agree, the courts distinguish between:

(i) Unenforceable obligations/rights arising from the parties having deferred their agreement on contractual terms (with either party remaining free to agree or disagree about the matter), and

(ii) Potentially enforceable obligations/rights arising from the parties having reached agreement on contractual terms (with certain elements remaining to be resolved in the future based on objective criteria or a particular mechanism, assessable by the courts pursuant to the parties’ agreement)

Contracting parties often find themselves under pressure to reach an agreement swiftly and as such may resort to leaving certain terms to a later date in order to “get the deal done”. *Morris* illustrates the risks associated with this approach and how saving time at the drafting stage can result in costly legal battles, which can be hugely disruptive to a business, particularly if it is the party seeking to rely on the term in question.

Parties should seek to try to achieve certainty of terms at the drafting stage. However, where flexibility is required or an important contractual term cannot be agreed at the time the contract is entered into, parties may wish to bear the following in mind:

- It may be prudent to include terms in the contract which will apply in the event that the parties are unable to reach their future agreement and which allow the terms of that agreement to be determined objectively, for example by a third party (such as via expert determination or arbitration). Such provisions can assist the parties in evidencing their intention to be legally bound by the contract
- In addition or in the alternative, criteria (eg an agreed formula or standard) might be included in the contract by which the outstanding term can be assessed objectively by the courts

There is no "one size fits all" term which can be relied on as the courts will reach their decision on enforceability based on their interpretation of the agreement as a whole. However, if a term gives the parties the opportunity to agree or disagree at a future point in time, whether reasonably or not, parties should assume that the courts will be slow to enforce such a term.

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1. *Hillas & Co Ltd v Arcos Ltd* [1932] All ER Rep 494
2. [2018] EWCA Civ 2763
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