Litigation

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English Contract Law: Has the Camel's Nose of "Good Faith" Crept Under the Tent Flap?

By Raymond L. Sweigart

Under the English Arbitration Act 1996 the grounds on which an English arbitration award can be challenged in court are very limited. Section 67 of the Act provides that a challenge may be brought on the basis that the arbitral Tribunal lacks substantive jurisdiction. That position can include the argument that the dispute has not been submitted to arbitration in strict compliance with the terms of the arbitration agreement. In Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd *[2014] EWHC 2104 (Comm), just such a section 67 challenge was brought alleging that the Tribunal lacked substantive jurisdiction. The challenge, however, failed, as the court concluded that though a required pre-arbitration "friendly discussion" was a condition precedent to arbitration, it had in fact occurred. However, in what might seem surprising given previous English case law, the court found that participation in such discussion obliged the parties to conduct good faith negotiations before commencing arbitration. This conclusion may reflect a growing interest among English judges in finding contractually implied obligations of good faith, consistent with the approach in other jurisdictions.*

The dispute itself is not particularly noteworthy or exceptional. It involved a long-term contract under which the defendant was to sell iron ore to the claimant. After the claimant had failed to acquire all of the iron ore which it was obliged to purchase during the first two years of the contract, the defendant sought liquidated damages and served notice of termination of the contract.

The contract provided for ICC arbitration in London, but also required:

> *In case of any dispute or claim arising out of or in connection with or under this LTC […], the Parties shall first seek to resolve the dispute or claim by friendly discussion. Any party may notify the other Party of its desire to enter into consultation to resolve a dispute or claim. If no solution can be arrived at in between the Parties for a continuous period of 4 (four) weeks then the non-defaulting party can invoke the arbitration clause and refer the disputes to arbitration.*

Some discussion apparently took place between the parties, but no resolution was reached and the defendant ultimately commenced arbitration. The claimant unsuccessfully contested jurisdiction before the arbitral tribunal and then applied to the English High Court under section 67, arguing that the Tribunal lacked substantive jurisdiction due to the defendant's failure to participate in friendly discussion as a condition precedent to arbitration.

The principal issues which Mr Justice Teare determined were:

1. How is the "friendly discussion" clause properly interpreted?
2. Is the clause enforceable under English law?
3. Was the clause, in fact, complied with?

Mr Justice Teare concluded that the requirement to seek to resolve the claim by friendly discussion was mandatory, as the parties had used the word "shall" in describing the obligation. By contrast, the requirement to give notice of a desire to enter into consultation was not mandatory since the parties had used the word "may". Thus, the judge concluded that the obligation to seek to resolve the dispute by friendly discussion was a condition precedent to arbitration. The four-week period referred to in the clause, however, did not necessarily require continuous discussions for that period, although discussions could be continuous, or the discussions could be for less than four weeks. What mattered is that they take place and proceedings could not be brought until expiry of the four-week discussion period.

Mr Justice Teare then considered whether the clause as interpreted is enforceable under English law. The defendant argued that it was not enforceable and the obligation to participate in discussion was a mere agreement to negotiate, citing the reasoning in *Walford v Miles*, [1992] 2 AC 128, in which the House of Lords had declined to enforce an obligation to negotiate as too uncertain. That case was distinguished as concerning an obligation to negotiate the acquisition of a company and did not involve negotiations prior to commencing litigation or arbitration. In *Cable & Wireless v IBM*, [2002] EWHC 2059, the High Court considered an obligation to attempt in good faith to resolve a dispute through the alternate dispute resolution (ADR) procedures of the Centre for Effective Dispute Resolution (CEDR). An agreement to invoke CEDR ADR was found to be sufficiently certain to be enforceable as providing an objective measure by which compliance could be determined. However, a bare obligation to negotiate in good faith as found in the instant contract arguably failed to satisfy this test of certainty. In *Sul America v Enesa Engenharis*, [2012] EWCA Civ 638, the Court of Appeal refused to enforce an obligation to resolve amicably a dispute by mediation in the absence of a defined mediation process or reference to the services of a specific mediation provider. Similarly, in *Wah v Grant Thornton*, [2013] EWHC 3198 (Ch), an agreement to refer disputes to a panel of three board members prior to arbitration was held too vague to be enforced as it did not enable the court to determine objectively what the parties' minimum obligations were or when the process would be exhausted.

The claimant also referred Mr Justice Teare to Australian and Singaporean authority, and awards from International Centre for the Settlement of Investment Disputes (ICSID) tribunals to support its argument that the discussion obligation should be enforceable. The judge found the reasoning in the Australian case of *United Group Rail Services v Rail Corporation New South Wales*, [2009] 127 Con LR 202, particularly

persuasive. In that case, an obligation to undertake genuine good faith negotiations to resolve a dispute was held to be enforceable. The New South Wales Court of Appeal considered the obligation to negotiate to be sufficiently constrained by the obligations of genuineness and good faith. The court also referred to the public policy in favour of resolution of disputes without recourse to arbitration or litigation. Mr Justice Teare distinguished *Walford v Miles*, as it did not involve a pre-litigation dispute resolution clause and so did not give rise to the same public interest considerations and did not specify a time period for negotiations. He also distinguished *Sul America v Enesa Engenharis* as that agreement was an incomplete referral to mediation.

The judge concluded that the time-bound "friendly discussion" obligation was sufficiently clear and objectively measurable to be enforceable, public interest militated in favour of giving effect to such an obligation, and there were no elements present that would give rise to uncertainty. The judge went on to consider that the obligation required negotiation in "good faith", which the judge took to mean taking an "honest and genuine approach" to settling the dispute.

Mr Justice Teare then concluded that, as a matter of fact, the required friendly discussion had taken place and the condition precedent had been satisfied. Therefore, the defendant had been entitled to commence arbitration, and the tribunal had jurisdiction. The claimant's section 67 challenge was therefore dismissed.

This decision contrasts with the English courts' traditional reluctance and more common refusal to enforce contractual provisions which do not set out precisely what a party must do as a condition precedent to arbitration. English law has also traditionally been resistant to reading into contracts a duty of good faith, reasoning that such a duty is uncertain, and contrary to the entitlement of parties to pursue their commercial self-interest in negotiations. Mr Justice Teare's decision to enforce an obligation to participate in friendly discussion is thus particularly surprising, as the judge also found that obligation implicitly requires participation in genuine and good faith discussions. However, in recent years, there has been evidence of a weakening of the traditional English position. Another example with a duty of good faith found in a commercial context can be found in the case of *Yam Seng PTE Ltd v International Trade Corporation Ltd*, [2013] EWHC 111 (QB). Like Mr Justice Teare, the *Yam Seng* court also relied on jurisprudence from other jurisdictions in reaching its conclusion. (See our prior article: *The Emergence of an Implied Duty of Good Faith in Contracts Governed by English Law*, authors Steven P. Farmer, Raymond L. Sweigart.)

It still remains to be seen whether this approach is followed by other judges in England, but there could be a growing receptivity to bringing English law on good faith more into line with that in other jurisdictions. Certainly, the camel's nose is now further into the tent. This reasoned, incremental approach is, of course, one of the beauties of a common law system.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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