WHERE AN AGREEMENT FAILS TO DELIVER

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Watson Farley & Williams acted for MRI Trading AG in a leading case on 'agreements to agree' that was finally decided by the Court of Appeal in 20131. That decision has recently been considered in the High Court by Mr Justice Walker in Teekay Tankers Ltd v STX Offshore & Shipbuilding Co. Ltd,2 a shipbuilding case of particular relevance to parties that enter into long-term agreements or options leaving delivery terms to be agreed.

AGREEING TO AGREE

Under English law, you cannot 'agree to agree'. Where parties agree that they will agree to enter into a contract and no such contract is concluded, that initial 'agreement' will be unenforceable or void on the basis of uncertainty. An English court will not step in to complete the parties' bargain where one or more essential terms of that bargain are uncertain.

However, parties may not want to fix every contractual term at the outset of their relationship. For example, in long-term supply contracts, they may wish to finalise certain terms only when future market circumstances are known.

A common way for drafters of contracts to achieve this is by reference to an objective standard, such as a published price index, against which a price adjustment can be made. However, even where the chosen mechanism fails or the contract does not provide for such a mechanism, there are circumstances in which English law will nevertheless uphold the parties' bargain.

The English courts have made it clear that each case is to be decided on its own facts and terms, but have identified factors that might indicate that the parties intended their bargain to be enforceable, in which case the courts will strive to give effect to that intention and seek, where possible, to preserve the parties' bargain.

THE FACTS OF TEEKAY

In Teekay v STX, subsidiaries of Teekay had entered into four shipbuilding contracts with STX ("the SBCs") and Teekay had entered into an option contract with STX by which Teekay was granted three options to order three additional sets of up to four vessels from STX ("the Option Agreement").

The Option Agreement provided that, on Teekay exercising each option, (subsidiaries of) Teekay would enter into shipbuilding contracts with STX on materially identical terms to the SBCs, but the "Delivery Dates for each [of the] Optional Vessels shall be mutually agreed upon at the time of [Teekay's] declaration of the relevant option". Importantly, the clause also provided that STX was to use its "best efforts" to "have a delivery" for each of the first set of optional vessels within 2016 and for each of the second and third sets of optional vessels within 2017.

The specific Delivery Date for each vessel was integral to the operation of the anticipated shipbuilding contracts that would then be concluded, including the delay, cancellation and liquidated damages provisions.

After Teekay exercised the first of the three options, STX's statements and conduct demonstrated that it would not perform the Option Agreement. Teekay accepted those statements and conduct as a repudiation at common law, as a result of which the Option Agreement came to an end with no agreement having been reached as to the Delivery Dates. Teekay claimed damages of over US$100m and STX defended the claim on the grounds that it had no liability to Teekay because the provision in the Option Agreement regarding Delivery Dates amounted to an 'agreement to agree' that was void for uncertainty.

For each set of vessels, Teekay asked the High Court to imply either of the following terms into the Option Agreement to resolve this apparent uncertainty:

1. the Delivery Date should be a date that STX offered within 2016 (for the first set of optional vessels) or 2017 (for the second and third sets) using its best efforts to do so, or, if STX was not able to offer such dates, the earliest date thereafter which it could offer using its best efforts ("the Offer Date Implied Term"); or
2. the Delivery Date was to be an objectively reasonable date (having regard to STX's best efforts), to be determined by the Court if not agreed by the parties ("the Reasonableness Implied Term").

THE DECISION

Mr Justice Walker considered the authorities in detail, including MRI, and found that the starting point should be that the parties had intended the Option Agreement to be legally binding and that the court should strive to uphold the parties' bargain.

Relevant factors taken into account by Mr Justice Walker in determining this starting point were that the Option Agreement formed part of a package of contracts that had been partially performed and the parties had acted as if the Option Agreement were binding.

From that starting point, Mr Justice Walker sought to determine whether the implied terms contended for by Teekay could properly be regarded as being the objective intention of the parties at the time they entered into the Option Agreement. Mr Justice Walker found that they were not and therefore they could not be implied, as a result of which the Option Agreement was void for uncertainty. In relation to each implied term, Mr Justice Walker's reasoning can be summarised as follows:

1. the Offer Date Implied Term would mean that the Delivery Dates would be at STX's unilateral declaration, which would be contrary to one of the English law tests for implying a contractual term. It was not said to be objectively obvious, at the time that Teekay and STX concluded the Option Agreement, that if a Delivery Date was not agreed STX should unilaterally be able to declare a Delivery Date; and

2. as to the Reasonableness Implied Term, two factors were of particular importance: (i) the Delivery Date was a critical term in the SBC that affected other provisions of the SBC; and (ii) the Delivery Date was subject to STX's "best efforts" obligation. As to the first factor, Mr Justice Walker noted that both parties would want to select a Delivery Date that suited their own commercial interests (which they were entitled to take into consideration) and their respective interests may be in conflict. As to the second, the language of "best efforts" implicitly recognised that the parties would have contrasting interests in selecting a Delivery Date. Those circumstances precluded an identification of a date based on what would be reasonable; there could hardly be an objectively reasonable outcome if the parties had completely divergent interests. The reference to "best efforts" was, in Mr Justice Walker's judgment, part of a process of seeking to agree an essential term in the SBC and very different from an enforceable obligation to use best efforts to achieve a result.

In this sense, the Teekay and STX Option Agreement can be seen as a "one off" contract in which no objective criteria had been specified to determine a Delivery Date. Selecting a Delivery Date would involve both Teekay and STX taking into account a variety of commercial and practical considerations, which might affect their ability and willingness to agree. In those circumstances, "reasonableness" was not a sufficient criterion that would enable the Court to reconcile the parties' potentially conflicting wishes.

CONCLUSION

It may come as a surprise to some commercial parties and seem somewhat unjust that otherwise carefully negotiated and detailed agreements might be held to be unenforceable or void because one or more (albeit essential) terms are uncertain. The courts have recognised this risk and have set out a clear and helpful framework against which they might uphold parties' bargains. However, the courts have stressed that each 'agreement to agree' case is to be decided on its own unique facts and terms.

In MRI, the High Court and the Court of Appeal upheld the bargain by implying a term that a price adjustment and delivery schedule should be "reasonable" where the agreement stated that those matters "shall be agreed" but the parties had not agreed them. A key factor in that case was that the agreement had been entered into as part of a settlement agreement compromising a previous dispute and the remainder of that settlement agreement had been fully performed. However, this was in principle similar to Teekay, which involved a suite of contracts. The court's attempt to distinguish MRI on the basis that deliveries under commodities contracts were matters of routine was not borne out by MRI, where the London Metal Exchange Tribunal had found as a matter of fact (acknowledged in the appeal proceedings) that shipping schedules were not to be dismissed as matters of detail and involved important considerations concerning the parties' commercial needs.

Teekay demonstrates that, absent any clear contractual path by which the court can pick its way through the parties' competing commercial interests, it may not be able to uphold a bargain despite striving to do so.

With this in mind, two drafting points of general importance arise from Mr Justice Walker's judgment.

1. Parties entering into contracts should ensure that all their contractual terms are certain at its outset or, if that is not possible, include a contractual mechanism against which a term can be determined in the absence of agreement.

2. Parties should consider carefully the mechanism that will be used. The inclusion of a non-specific "best efforts" obligation in the Option Agreement may have been intended to compel STX to take appropriate action, but in fact worked against the implication of a term by the court. Teekay would have been in a better position if the Option Agreement had provided for a specific objective mechanism to set the Delivery Date, but, according to the reasoning of the court, may also have been in a better position if it had said nothing about "best efforts" at all.

At the time of writing it does not appear that this decision has been appealed, perhaps owing to the bankruptcy of STX.

1 MRI Trading AG v Erdenet Mining Corp LLC [2013] EWCA Civ 156

2 [2017] EWHC 253 (Comm)

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