Dispute Resolution

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DISPUTE RESOLUTION BULLETIN

Heads of Agreement can be legally binding - an Australian decision

A recent decision of the New South Wales Court of Appeal, *Malago Pty Ltd v AW Ellis Engineering Pty Ltd (27 July 2012)*, is a reminder that Heads of Agreement may be legally binding, even though subsequent formal agreements are not concluded.

The Appellants had entered into a business sale agreement with the Respondents to purchase a marina business in Sydney. During the purchase negotiations, a dispute arose which was referred to mediation. At the conclusion of the mediation, the mediator prepared Heads of Agreement which provided for the Appellants to purchase the Respondent's interest in the business.

Following the mediation, the parties attempted to agree the terms of a more formal document to give effect to the Heads of Agreement. However, the Appellants withdrew from the negotiations, apparently due to a shortage of funds to complete the purchase. The Respondents commenced proceedings, seeking a declaration that a binding agreement for the sale existed and an order for specific performance and damages. The Respondents were successful at first instance. The Appellants appealed.

The Court of Appeal upheld the first instance decision and found that on their proper construction, the Heads of Agreement were intended by the parties to be legally binding and were not void for uncertainty or incompleteness. The judge at first instance had found that the language in the Heads of Agreement, notably the words: *"without affecting the binding nature of these Heads of Agreement"* were *"the clearest indication that the parties intended immediately to be bound"*. The Court of Appeal agreed.

The Court of Appeal held that whether the parties intended to enter into a binding contract must be objectively ascertained from the terms of the document read in light of the surrounding circumstances, whilst noting the limitation upon the use that may be made of such surrounding circumstances. Even when a document

recording the terms of the parties' agreement specifically refers to the execution of a formal contract, the parties may be immediately bound.

However, as for the negotiations between the parties' respective solicitors after the Heads of Agreement had been signed, the Court of Appeal did not accept that the parties had reached any binding agreements concerning particular clauses during these. The parties did not intend to be bound by terms agreed by their solicitors without requisite instructions from their clients.

The Court of Appeal was of the view that the Heads of Agreement specifically provided for the terms of the contemplated "formal document" to be agreed upon by the parties' solicitors.

The Court therefore varied the judgment at first instance and ordered specific performance of the Heads of Agreement by the parties entering into a formal contract containing terms to the same effect as appeared in the Heads of Agreement and that had been mutually agreed. It ordered the Appellants to perform the formal contract for the sale of the business.

Commercial parties should take care when negotiating Heads of Agreement to ensure that they accurately reflect the parties' intentions. If they are not intended to be binding upon the parties, they should say so in express terms.

For more information, please contact Chris Lockwood, Partner, on +61 (0)8 9422 4711 or chris.lockwood@hfw.com, or your usual contact at HFW.

Reform of the Brussels I Regulation

Regulation (EC) 44/2001 on jurisdiction and the recognition and enforcement of judgments is known as the Brussels I Regulation. It is the main piece of EU legislation on cross-border litigation. It sets out the rules on jurisdiction and seeks to ensure the free movement of judgments in civil and commercial matters between EU Member States.

Reform of the Brussels I Regulation has been underway since April 2009. It has now been recast as Regulation (EU) 1215/2012 (the recast Regulation). This entered into force in January 2013, although the majority of its provisions will not be applied by Member State courts until January 2015.

The recast Regulation leaves the basic jurisdictional rules unchanged, but simplifies the procedure for the recognition and enforcement of the judgments of member state courts, strengthens the position of contractual jurisdiction clauses and amends the *lis pendens* (dispute pending elsewhere) provisions to prevent tactical abuse.

A key clarification on arbitration clauses has also been included: the recast Regulation clearly states that arbitration is outside its scope.

Previously, in order to enforce a judgment given by a court in another Member State, it was necessary to obtain a court order from the Member State where enforcement was sought, registering the judgment and declaring it enforceable. This process, known as *exequatur*, has been abolished by the recast Regulation. A judgment given by a Member State court will now be recognised in other Member States without any specific procedure and, if it is enforceable in the Member State of origin, it will be enforceable in other Member States without any declaration.

Under the Brussels I Regulation, where proceedings had been commenced in a Member State court, that court (the court first seised) had the right to determine whether or not it had jurisdiction to hear the dispute. Any proceedings subsequently commenced in the courts of another Member State between the same parties, in relation to the same cause of action, had to be stayed until the court first seised had ruled on jurisdiction. This process applied even if the proceedings in the court first seised had been brought in breach of a contractual jurisdiction clause.

This gave rise to a problem known as the "Italian Torpedo", whereby a party would commence proceedings in the "wrong" jurisdiction, in breach of the contractual jurisdiction clause, for tactical reasons. It could lead to a substantial delay if the court first seised was one in which litigation proceeds slowly, or in which jurisdiction is determined at the same time as the substantive dispute, rather than as a preliminary matter.

Article 31(2) of the recast Regulation addresses this problem by providing that if proceedings are commenced in a Member State in breach of an agreement which confers exclusive jurisdiction on the courts of another member state, the court in which proceedings have been commenced must stay proceedings until the court named in the agreement rules on its

jurisdiction. (Article 31(2) does not apply to certain insurance, employee and consumer matters.)

A number of other provisions in the recast Regulation also strengthen the position of contractual jurisdiction clauses.

Article 25(5) states that a jurisdiction agreement in a contract shall be treated as an agreement independent of the contract's other terms and that its validity cannot be contested solely on the ground that the contract is not valid.

The recast Regulation has removed the requirement (in Article 23 of the existing Regulation) that at least one party must be domiciled in a Member State for the Regulation to apply. This widens the scope of jurisdiction agreements caught by the Regulation and will avoid the need for investigation into the domicile of the parties.

Article 33 of the recast Regulation provides Member State courts with a new discretion to stay proceedings in favour of a non-Member State court if (i) the non-Member State court was first seised; (ii) it is expected that the non-Member State court will give a judgment capable of recognition and enforcement in the Member State concerned; and (iii) a stay is necessary for the proper administration of justice. Article 34 of the recast Regulation provides a similar discretion for Member State courts to stay proceedings where a non-Member State court has been first seised in a related action and it is expedient to hear the related actions together to avoid the risk of irreconcilable judgments.

These changes appear to be practical responses to difficulties faced by litigators in the EU under the Brussels I Regulation. We shall not see how effective they are in practice until 2015.

For more information please contact Jane Hugall, Associate, on +44 (0)20 7264 8206 or jane.hugall@hfw.com, or your usual contact at HFW.

Do parties to a commercial contract have a duty to act in good faith?

English courts have historically been reluctant to imply a duty to act in good faith into commercial contracts. A recent English High Court judgment, *Yam Seng Pte Limited v International Trade Corporation Limited (1 February 2013)* heralds a change to this attitude: a duty of good faith may now be implied into certain commercial contracts.

Many civil law systems recognise an overriding principle that in making and carrying out contracts, parties should act in good faith. In 1992, the New South Wales Court of Appeal recognised that an implied contractual duty of good faith may occur depending on the factual matrix. Subsequent Australian decisions implied the duty in commercial contracts as a matter of law.

Before the *Yam Seng* decision, English law already recognised a duty of good faith, but only in relation to certain types of contract, such as contracts of employment. In relation to commercial contracts, it has been non-committal. In 1992 - the same year as the New South Wales judgment - the House of Lords rejected the argument that a duty of good faith may be implied, declaring that: "[t]he concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties".

The commercial contract in the *Yam Seng* case concerned the exclusive rights to distribute fragrances in the Middle East, Asia, Africa and Australasia for an initial fixed period of a year, later extended by a further twenty months. Yam Seng terminated the contract, claiming damages for breaches of the agreement including late shipment of orders. One of its arguments was that it was an implied term of the contract that the parties would deal with each other in good faith.

In its judgment, the Court recognised that although there was "traditional English hostility" towards a doctrine of good faith, a refusal to recognise such a duty would be "swimming against the tide" not only because the principle is well-established in other jurisdictions, but also because references to good faith have already been received into English law via EU legislation.

The Court observed that English law is not ready to recognise the duty of good faith in all commercial contracts as a general rule. However, there should be no difficulty in implying a duty in any ordinary commercial contract based on the presumed intention of the parties. Particular reference was made to longer term contracts where the parties make a substantial commitment such as joint venture, franchise and distributorship agreements.

Some commercial parties may welcome this decision. Others may want to consider whether to make

express provision in their contract that no duty of good faith is to be implied, since the duty may impose legal obligations beyond what they are prepared to offer. This could be achieved by stating that certain decisions are at one party's "sole" or "absolute" discretion.

For more information, please contact Flora Stewart, Associate, on +44 (0)20 7264 8517 or flora.stewart@hfw.com, or your usual contact at HFW.

GAR 100

Global Arbitration Review has just launched the 6th edition of its GAR 100 listing and HFW is delighted that its International Arbitration practice has been included for the first time. GAR 100 is a global guide to the international arbitration capabilities of law firms. Head of International Arbitration at the firm, Partner Damian Honey, commented "I am extremely pleased that Global Arbitration Review has recognised the capabilities of HFW's international arbitration practice. We have enhanced our capabilities in this field extensively over the last few years and our listing in the GAR 100 is testament to that."

HFW Seminars

HFW will be hosting a series of International Arbitration and Dispute Resolutions seminars in the next few months, in our Asia Pacific offices and in London. They are aimed at in-house lawyers and others with an interest in the area. If you would like further details, please contact events@hfw.com.

Conferences & Events

HFW International Arbitration Seminars
Sydney (Tuesday 19 March 2013)
Melbourne (Wednesday 20 March 2013)
Perth (Friday 22 March 2013)
Hong Kong (Tuesday 16 April 2013)
Singapore (Friday 19 April 2013)
London (Tuesday 30 April 2013)

HFW Dispute Resolution Seminars
HFW London
(17 April and 14 May 2013)

Lawyers for international commerce hfw.com

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
United Kingdom
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888