

*AGREEMENTS TO AGREE: CAN THERE EVER  
BE AN ENFORCEABLE DUTY TO  
NEGOTIATE IN GOOD FAITH?\**

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I A DUTY TO NEGOTIATE IN GOOD FAITH

The dispute in a recent Supreme Court of Appeal case, *Southernport Developments (Pty) Ltd v Transnet Ltd*,<sup>1</sup> concerned a term in a contract which gave one party an option (in the event of a separate condition not being fulfilled at a future date) ‘to lease the properties . . . on the terms and conditions of an agreement . . . negotiated between the parties in good faith and approved by each party’s board of directors’.<sup>2</sup> A further clause in this agreement provided that should the parties be unable to reach agreement on the outstanding terms in the future, these were to be submitted for decision by an arbitrator.<sup>3</sup> It was held by the Supreme Court of Appeal that this deadlock-breaking provision was sufficient to take the contract in question beyond the realm of being an unenforceable agreement to agree.<sup>4</sup> Rather the court held that

‘[t]he second agreement had settled all of the essential terms between the parties and was immediately binding, although fuller negotiations to settle subsidiary terms were still within the contemplation of the parties, in accordance with the continuing relationship between them. Simply put, the arbitrator was entrusted with putting the flesh onto the bones of a contract already concluded by the parties’.<sup>5</sup>

The *Southernport Developments* case was thus simplified by the presence of a deadlock-breaking mechanism in the parties’ own contract. Indeed, with reference to a similar Australian case,<sup>6</sup> Ponnann AJA distinguished two further scenarios: first, where ‘by reference to a readily ascertainable standard, the

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<sup>1</sup> 2005 (2) SA 202 (SCA).

<sup>2</sup> Ibid para 3.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid para 17.

<sup>5</sup> Ibid.

<sup>6</sup> *Coal Cliff Collieries (Pty) Ltd v Sijehama (Pty) Ltd* (1991) 24 NSWLR 1.

court may be able to add flesh to a provision which is otherwise unacceptably vague or uncertain or apparently illusory'.<sup>7</sup> Secondly, where 'the promise to negotiate in good faith will occur in the context of an "arrangement" (to use a neutral term) which, by its nature, purpose, context, other provisions or otherwise makes it clear that the promise is too illusory or too vague and uncertain to be enforceable'.<sup>8</sup> The first scenario above was not discussed further in the case, although Christie in his textbook on South African contract law shows with reference to several cases that this too might avoid the pitfalls of being an unenforceable agreement to agree.<sup>9</sup> The second category of cases above was unenforceable, according to Ponnar AJA, because of the 'absolute discretion vested in the parties to agree or disagree'.<sup>10</sup>

There is thus clear authority in South Africa that a provision in a contract imposing on the parties a duty to negotiate further terms in good faith is enforceable, provided an arbitration clause is included. This paper will take the inquiry a step further. What if there is no deadlock-breaking mechanism? There will be an assumption here that the duty to negotiate in good faith is contained in some form of binding preliminary agreement, otherwise such a term would fall into the second category of cases sketched above, which would appear to be unenforceable. Thus the grey area of the first category of cases will be explored, with reference to a general set of facts. Consider the following scenario:

- Two contracting parties have reached a preliminary agreement which is binding and which imposes on them a set of contractual obligations.
- Certain open terms in the agreement remain to be resolved, however. These are intended to flesh out the agreement at a later date.
- The preliminary agreement states that these open terms will be negotiated between the parties in the future in good faith.

If the contractual relationship between the parties breaks down at a later date and one party refuses to continue with negotiations, can the other seek redress for this breach of the preliminary agreement?

## II AGREEMENTS TO AGREE IN SOUTH AFRICAN LAW

What should be clear from the above discussion of the finding in *Southernport Developments* is that there are different classes of agreements to agree in South

<sup>7</sup> *Southernport Developments* supra note 1 para 16. The quoted extract comes from *Coal Cliff Collieries* supra note 6 at 27A.

<sup>8</sup> Ibid. The quoted extract comes from *Coal Cliff Collieries* supra note 6 at 27B.

<sup>9</sup> R H Christie *The Law of Contract in South Africa* 5 ed (2006) 38. See in particular *NBS Boland Bank Ltd v One Berg River Drive CC & others; Deeb & another v ABSA Bank Ltd; Friedman v Standard Bank of SA Ltd* 1999 (4) SA 928 (SCA); *Soteriou v Retco Poyntons (Pty) Ltd* 1985 (2) SA 922 (A) at 931–4; *Erasmus & others v Senwes Ltd & others* 2006 (3) SA 529 (T) at 537–8.

<sup>10</sup> *Southernport Developments* supra note 1 paras 11 and 16. The case authority given for this finding is *Premier, Free State & others v Firechem Free State (Pty) Ltd* 2000 (4) SA 413 (SCA).

African law.<sup>11</sup> In the case of *Southernport* as well as in another leading Supreme Court of Appeal case, *Letaba Sawmills (Edms) Bpk v Majovi (Edms) Bpk*,<sup>12</sup> a binding preliminary agreement which contained open terms as to the conditions of a future lease of defined property (*Southernport*), or an option to renew a lease at a rental to be negotiated (*Letaba Sawmills*), was held to be valid, given the existence of an arbitration provision.<sup>13</sup>

In the absence of a binding preliminary agreement, the present state of South African law is more in favour of the party attempting to resile from negotiations. In *Premier, Free State, & others v Firechem Free State (Pty) Ltd*<sup>14</sup> a letter of acceptance by the respondents which attempted to place an obligation on the appellants to negotiate further was held not to constitute a binding contract and that the terms it contained were in any event an unenforceable 'agreement to agree'.<sup>15</sup> The term in the acceptance letter attempting to impose this obligation vested absolute discretion in the parties to agree or disagree, and hence did not bind.<sup>16</sup> A similar finding was reached in *H Merks & Co (Pty) Ltd v The B-M Group (Pty) Ltd*.<sup>17</sup> There a clause in an ongoing supply agreement to the effect that the parties could increase the sale price from time to time by mutual agreement was held to be unenforceable.<sup>18</sup> The parties had reached a stalemate over a proposed price increase and in the absence of agreement over the future sales price, the court declined to enforce the agreement at the appellant's request.<sup>19</sup> The Appellate Division thus refused to supply a reasonable price.<sup>20</sup>

The dispute in *CGEE Alsthom Equipments et Enterprises Electriques, South African Division v GKN Sankey (Pty) Ltd*<sup>21</sup> concerned the validity of a telex message to the respondent which confirmed an earlier oral award of a contract to it. The appellant was constructing the nuclear power station at Koeberg in the Western Cape and the respondent was to supply steel guttering to support electric cables at the plant. The appellant orally confirmed that the contract had been given to the respondent and requested that it order steel in the meantime. The respondent, however, demanded that this acceptance be placed in writing, which prompted the telex from the appellant. Ultimately negotiations broke down between the parties, after the steel had been ordered, but before performance had taken place. The dispute

<sup>11</sup> For a discussion of issues surrounding agreements to agree, particularly with regard to pre-emption contracts, see Deeksha Bhana 'The contract of pre-emption as an agreement to agree' (2008) 71 *THRHR* 568.

<sup>12</sup> 1993 (1) SA 768 (A).

<sup>13</sup> *Southernport Developments* supra note 1 para 17. *Letaba Sawmills* supra note 12 at 775–6.

<sup>14</sup> Supra note 10.

<sup>15</sup> *Firechem* ibid paras 35 and 37.

<sup>16</sup> Ibid para 35.

<sup>17</sup> 1996 (2) SA 225 (A).

<sup>18</sup> Ibid at 233I–234A.

<sup>19</sup> Ibid at 235C–D.

<sup>20</sup> Ibid.

<sup>21</sup> 1987 (1) SA 81 (A).

then centred on whether a binding contract had been formed and whether the respondent was entitled to its reliance expenditure.

Corbett JA, for a unanimous Appellate Division, used offer and acceptance analysis to determine this issue.<sup>22</sup> He held that the telex did constitute a binding acceptance of the respondent's offer.<sup>23</sup> The appellant's further contention was that 'a number of material and important matters relating to the work to be performed under the contract were still being negotiated by the parties' and hence this telex was not binding.<sup>24</sup> Corbett JA held, however, that the existence of 'outstanding matters' did not necessarily deprive an agreement of binding force.<sup>25</sup> The judge of appeal held that the unambiguous wording of the telex, the circumstances under which it had been sent and the subsequent conduct of both parties indicated that it was a binding acceptance.<sup>26</sup> The respondents were awarded the full expectation interest measure of damages.<sup>27</sup> While this was not an instance of an agreement to agree, it is a useful case in this context since it indicates that one can have a binding agreement even if some issues still remain open for future negotiation.

In *Namibian Minerals Corporation Ltd v Benguela Concessions Ltd*<sup>28</sup> a contract between the parties attempted to create a right to exploit a diamond mining concession along the coast of Namibia. The parties signed a preliminary 'Heads of Agreement', a clause of which created a suspensive condition that should a third party, who held part of the mining concession which the agreement intended to exploit, not grant it an extension of this concession after three years, the respondents would grant the appellants a right to exploit a separate concession which it owned in South Africa on terms which were to be agreed upon, but which were to be no less favourable than those of the present agreement. With regard to the interpretation of this clause, the majority decision of the Appellate Division was careful to state that '[b]usinessmen are often content to conduct their affairs with only vague or incomplete agreements in hand'.<sup>29</sup> Harms JA quoted an extract from the House of Lords decision in *Hillas and Co Ltd v Arcos Ltd*<sup>30</sup> to the effect that the agreement should be interpreted so that the contract could rather be upheld than that it should fail, in accordance with the well-known maxim 'ut res magis valeat quam pereat'.<sup>31</sup> The clause in question, however, required

<sup>22</sup> Ibid at 90–4.

<sup>23</sup> Ibid at 90–1.

<sup>24</sup> Ibid at 91–2.

<sup>25</sup> Ibid at 92.

<sup>26</sup> Ibid at 93–4.

<sup>27</sup> Ibid at 95.

<sup>28</sup> 1997 (2) SA 548 (A).

<sup>29</sup> Ibid at 561 per Harms JA.

<sup>30</sup> [1932] All ER 494 (HL), (1932) 147 LT 503.

<sup>31</sup> *Namibian Minerals Corporation* supra note 28 at 562. The extract referred to comes from the judgment of Lord Wright at 503–4 where he states: 'It is, accordingly, the duty of the court to construe such documents fairly and broadly, without being

not only the fulfilment of a suspensive condition, but such fulfilment needed also the consensus of the parties.<sup>32</sup> It did not therefore give rise to an enforceable option which contained further terms for negotiation; it was an agreement to agree with many variables present.<sup>33</sup> The court thus held the clause to be void for vagueness.<sup>34</sup>

There are also cases which, although they do not contain a duty to negotiate in good faith, still contain open terms. In *NBS Boland Bank v One Berg River Drive CC*<sup>35</sup> the Supreme Court of Appeal was concerned with a power of a bank to vary the interest rate of a mortgage repayment unilaterally in terms of a provision in the mortgage contract. It was held that this was not a completely unfettered discretion, whereby a party could determine its own prestation, but rather a discretionary power, the exercise of which had to measure up to a standard of objective reasonableness.<sup>36</sup> This standard was referred to by the court as the ‘*arbitrium boni viri*’.<sup>37</sup> In an aside the court added that this limitation on the exercise of a contractual power could also have been achieved by an application of ‘the modern concept of the role of public policy, bona fides and contractual equity’.<sup>38</sup>

In *Erasmus & others v Senwes Ltd & others*,<sup>39</sup> a power in an employment contract to vary the terms of the agreement at the discretion of the employer was held not to be an unfettered power, but also to be subject to the standard of *arbitrium boni viri* and hence valid.<sup>40</sup> What emerges from this line of cases is that a unilateral power under a contract to determine future terms of that contract is valid in South African law, provided the exercise of that power can be held accountable to a standard of objective reasonableness and does not leave prestation to the completely unfettered discretion of one party alone.

As far as the present problem involves the enforcement of a duty to negotiate open terms, a parallel can be drawn with the comparable issue of contracts creating a right of first refusal. These typically leave the determina-

too astute or subtle in finding defects; but, on the contrary, the court should seek to apply the old maxim of English law, *verba ita sunt intelligenda ut res magis valeat quam pereat*.’

<sup>32</sup> *Ibid* at 567.

<sup>33</sup> *Ibid*.

<sup>34</sup> *Ibid*.

<sup>35</sup> *Supra* note 9.

<sup>36</sup> *Ibid* at paras 24–5. This view was, however, dismissed as incorrect and obiter by the majority of the Supreme Court of Appeal in *Brisley v Drotzky* 2002 (4) SA 1 (SCA) para 16.

<sup>37</sup> I borrow the translation of ‘*arbitrium boni viri*’ as a ‘standard of objective reasonableness’ from Deeksha Bhana ‘The enforcement of pre-emption: a proposed new form of specific performance’ (2010) 73 *THRHR* 288 at 291. Bhana adds that the determination of this standard is informed by the values of the South African Constitution. In *Erasmus v Senwes Ltd* *supra* note 9, Du Plessis J approved a translation of this phrase as ‘the decision of a good man’, explained as ‘a reasonable decision’ (at 538).

<sup>38</sup> *NBS Boland Bank* *supra* note 9 para 27.

<sup>39</sup> *Supra* note 9.

<sup>40</sup> *Ibid* at 537–8.

tion of the sale price or rental payment open for discussion for a possible future date when the grantor of the right of first refusal may wish to make an offer to the grantee. A difficult issue in this type of case is whether the grantee can enforce the right against the grantor and under what circumstances this would be allowable. The issue is squarely in the realm of good faith negotiation of open terms.

Consider the case of *Soteriou v Retco Poyntons (Pty) Ltd*,<sup>41</sup> where a clause in a lease agreement created a right of first refusal in favour of the lessee to renew the lease for a further period of almost five years ‘upon such terms and conditions and at such rental as may be mutually agreed upon’.<sup>42</sup> This clause was interpreted by the court as meaning that the terms and conditions are those which the lessor would offer to other would-be lessees, should the current lessee not exercise its right of first refusal and was therefore not void for uncertainty.<sup>43</sup> The lessor was in the circumstances obliged to make an offer to the lessee, who would then have the election whether or not to renew the contract.<sup>44</sup> The court held as follows:

‘Poynton’s [the lessor] was accordingly under an obligation to offer Soteriou a new lease of shop 18. Plainly any offer had to be one which was capable of being turned into a contract by acceptance. It had therefore to state a rental and any other terms and conditions which Poynton’s required. . . . Poynton’s was not free to fix any rental it pleased. . . . Plainly Poynton’s must act *bona fide*.’<sup>45</sup>

This case thus creates a duty on the grantor of a right of first refusal to make a bona fide offer to the right holder should she wish to sell or let the item in question.<sup>46</sup> Bhana takes it one step further and argues that a form of specific performance should be available to the grantee, whereby, in the event of a sale by the grantor to a third party, a court should be able to impose on the grantor a duty to make an offer in favour of the grantee, determined according to an objectively reasonable standard (*arbitrio boni viri*).<sup>47</sup> Whether or not Bhana’s arguments are accepted, the right of first refusal

<sup>41</sup> 1985 (2) SA 922 (A).

<sup>42</sup> *Ibid* at 929.

<sup>43</sup> *Ibid* at 933.

<sup>44</sup> *Ibid* at 933–4.

<sup>45</sup> *Ibid* at 932H–J.

<sup>46</sup> Luanda Hawthorne & Dale Hutchison ‘Offer and acceptance’ in Dale Hutchison and Chris-James Pretorius (eds) *The Law of Contract in South Africa* (2009) at 72. On the duties of the grantor of a right under a preference contract in general see Bhana *op cit* note 25 at 292–5. This interpretation of the so-called ‘trigger event’, which manifests the intention of the grantor to sell and thereby gives rise to a duty to make an offer to the grantee, is disputed by Tjakkie Naudé ‘The rights and remedies of the holder of a right of first refusal or preferential right to contract’ (2004) 121 *SALJ* 636. Naudé argues at 646–7 that ‘nothing short of a valid offer to, or contract with a third party should amount to breach by the grantor’. The grantor should be ‘left as free as possible to negotiate with third parties in order to sound out the market and ultimately to obtain the best price’. See also Tjakkie Naudé ‘Which transactions trigger a right of first refusal or preferential right to contract?’ (2006) 123 *SALJ* 461.

<sup>47</sup> Bhana *op cit* note 37 at 301–2.

analogy is illuminating in two respects: first, a duty to negotiate an agreement at a future date is viewed as binding by the courts and has even been interpreted as giving rise to a duty to make a bona fide offer. Secondly, the courts in this context are grappling with how to enforce this positive obligation, but the Appellate Division has held that such an obligation is at least in principle enforceable.<sup>48</sup>

In sum, therefore, open terms are acceptable in South African law, provided they are contained in a binding preliminary agreement and are enforceable by some deadlock-breaking provision. The existence of a preliminary agreement would obviously be a question of fact to be determined by offer and acceptance analysis. In the words of Corbett JA:

‘There is no doubt that, where in the course of negotiating a contract the parties reach an agreement by offer and acceptance, the fact that there are still a number of outstanding matters material to the contract upon which the parties have not yet agreed may well prevent the agreement from having contractual force. . . . The existence of such outstanding matters does not, however, necessarily deprive an agreement of contractual force. The parties may well intend by their agreement to conclude a binding contract, while agreeing, either expressly or by implication, to leave the outstanding matters to future negotiation with a view to a comprehensive contract. In the event of agreement being reached on all outstanding matters the comprehensive contract would incorporate and supersede the original agreement. If, however, the parties should fail to reach agreement on the outstanding matters, then the original contract would stand.’<sup>49</sup>

As illustrated above, courts prefer to give effect to the intentions of business people and hold that a valid agreement exists, rather than to strike it down for uncertainty. Hence open terms may give rise to a valid power, for instance where they create an ability unilaterally to determine a rental price or interest rate, provided the exercise of such power is objectively reasonable. What is more contentious is whether such power to make an objectively reasonable determination of the content of an agreement can be extended, beyond the parties to that agreement, to a tribunal attempting to enforce a duty to negotiate. Clearly a court would have to be careful not unacceptably to limit freedom of contract by imposing an entirely new contract on the parties. If the majority of the terms of a contract have been agreed upon, however, surely it is not too big a stretch to determine a market-related term such as a sale price or rental amount by objectively reasonable determination?

This type of argument draws on the implication in *NBS Boland Bank* that good faith or public policy could stand as a limitation upon the exercise of a power under a contract. Given the role which the Constitutional Court has

<sup>48</sup> *Soteriou* supra note 9 at 935. See also *Owsianick v African Consolidated Theatres (Pty) Ltd* 1967 (3) SA 310 (A) per Ogilvie Thompson JA at 320F–G; *Associated South African Bakeries (Pty) Ltd v Oryx & Vereinigte Bäckereien* 1982 (3) SA 893 (A) at 907–8. See also Naudé ‘The rights and remedies of the holder of a right of first refusal’ op cit note 46 at 636–8.

<sup>49</sup> *CGEE Alstom Equipments* supra note 21 at 92.

carved out for public policy in the more recent case of *Barkhuizen v Napier*,<sup>50</sup> the ability of courts to achieve a fair result through adjudication of what is objectively reasonable has been enhanced. In *Barkhuizen* the Constitutional Court stated:

‘Notions of fairness, justice and equity, and reasonableness cannot be separated from public policy. Public policy takes into account the necessity to do simple justice between individuals. Public policy is informed by the concept of ubuntu. It would be contrary to public policy to enforce a time-limitation clause that does not afford the person bound by it an adequate and fair opportunity to seek judicial redress.’<sup>51</sup>

This adds weight to the ratio in *NBS Boland Bank* that public policy could limit the exercise of a contractual power by imposing a standard of reasonableness on the person concerned. Furthermore, the implication of the last sentence of the extract above is that public policy also binds a court in the enforcement of contractual rights, so that a court should not enforce contractual terms which are unfair or unreasonable. This has subsequently been qualified by the Supreme Court of Appeal, however, so that enforcement of a contractual term will only be limited if ‘a public policy consideration found in the Constitution or elsewhere is implicated’.<sup>52</sup> This finding, in the *Bredenkamp* case, presents the latest instalment in the ongoing saga of the movement of South African contract law toward more altruist values.<sup>53</sup> Ever since the demise of the *exceptio doli generalis* in *Bank of Lisbon and South African Ltd v De Ornelas*,<sup>54</sup> the role of equitable considerations in South African contract law has been controversial.<sup>55</sup> The general trend has, however, been toward more substantive values and a concern for fairness *inter partes*.<sup>56</sup> This culminated in the Constitutional Court judgments in *Barkhuizen*, which seemed to provide an overarching requirement of fairness

<sup>50</sup> 2007 (5) SA 323 (CC).

<sup>51</sup> *Ibid* para 51 per Ngcobo J.

<sup>52</sup> *Bredenkamp v Standard Bank of SA Ltd* 2010 (4) SA 468 (SCA) para 50.

<sup>53</sup> Compare the discussion in Alfred Cockrell ‘Substance and form in the South African law of contract’ (1992) 110 *SALJ* 40. The term ‘altruist’ is taken from Duncan Kennedy ‘Form and substance in private law adjudication’ (1975–1976) 89 *Harvard LR* 1685.

<sup>54</sup> 1988 (3) SA 580 (A).

<sup>55</sup> See particularly: *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 (4) SA 302 (SCA); *Brisley v Drotzky* 2002 (4) SA 1 (SCA); *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA); Gerhard Lubbe ‘Bona fides, billikheid en die openbare belang in die Suid-Afrikaanse kontraktereg’ (1990) *Stell LR* 7; Reinhard Zimmermann ‘Good faith and equity’ in Reinhard Zimmermann & Daniel Visser (eds) *Southern Cross: Civil Law and Common Law in South Africa* (1996) 217; Dale Hutchison ‘Good faith in the South African law of contract’ in Roger Brownsword, Norma J Hird & Geraint Howells (eds) *Good Faith in Contract: Concept and Context* (1999) 213.

<sup>56</sup> For example: *Du Toit v Atkinson’s Motors Bpk* 1985 (2) SA 893 (A); *Sasfin v Beukes* 1989 (1) SA 1 (A); *Sonap Petroleum (Pty) Ltd v Pappadogianis* 1992 (3) SA 234 (A); the minority judgment of Olivier JA in *Saayman NO* supra note 55, but see the criticism of this judgment by the majority in *Brisley* supra note 55 and *Afrox* supra note 55; *Brink v Humphries & Jewell (Pty) Ltd* 2005 (2) SA 419 (SCA).

in contracting.<sup>57</sup> This over-arching requirement was negated by the Supreme Court of Appeal in *Bredenkamp*, as set out above, which appears to be where the matter rests at the moment.<sup>58</sup>

While altruist values are on the rise, however, the traditional notion of good faith seems to have been abandoned as a vehicle for change in favour of public policy.<sup>59</sup> To say that there is no independent requirement of good faith in South African contract law, however, is not to say that bad faith will be condoned. While good faith may import an objective standard of fair dealing, bad faith seems to suggest a more subjective standard. Indeed bad faith conduct seems to imply something akin to deliberate conduct on the part of the culprit. Should a court strike down bad faith conduct under a contract on grounds of objective reasonableness and fairness?<sup>60</sup>

Compare in this regard the judgment of the Supreme Court of Appeal in *South African Forestry Co Ltd v York Timbers Ltd*.<sup>61</sup> Here SAFCOL was the supplier of logs to a sawmill owned by York. The contract had been entered into 30 years previously and contained a clause in terms of which the supplier could raise the price of logs. SAFCOL was the successor to the South African government as the supplying party under the contract. The price increase mechanism was an agreement to agree in the future, but was able to be referred to the relevant government minister, or even an arbitrator, to break a deadlock. From the outset, however, York frustrated every attempt of SAFCOL to raise the price. There was no provision for SAFCOL to escape the contract and as a result it was locked into supplying logs at a price way below market value. After all attempts to reach agreement failed, SAFCOL ended up in the Supreme Court of Appeal, arguing (inter alia) that York was in breach of an implied term to act in good faith.<sup>62</sup> The Supreme Court of Appeal held that such a duty of good faith did not exist, based on the prevailing view of fairness in contracting at the time.<sup>63</sup> The court expressly

<sup>57</sup> See for example the quoted extract above which appeared in *Barkhuizen* supra note 50 para 51, as well as the argument advanced by counsel in the SCA decision in *Bredenkamp* supra note 52 para 26.

<sup>58</sup> It should be noted that leave to appeal to the Constitutional Court was denied to the appellant, *Bredenkamp*, and hence the matter rests here.

<sup>59</sup> See *Barkhuizen* supra note 50 paras 79–82, 120. The definition of good faith in para 80 of the majority judgment seems to overlap with the definition of public policy given at para 51. A clearer distinction is drawn between these concepts in Hector MacQueen ‘Good Faith’ in Hector MacQueen & Reinhard Zimmermann (eds) *European Contract Law* (2006) at 65.

<sup>60</sup> See Graham Glover ‘Lazarus in the Constitutional Court: an exhumation of the exceptio doli generalis?’ (2007) 124 *SALJ* 449 and A J Kerr ‘The defence of unfair conduct on the part of the plaintiff at the time the action is brought: the exceptio doli generalis and the replicatio doli in modern law’ (2008) 125 *SALJ* 241 to the effect that *Barkhuizen* could be read as a resurrection of the old exceptio doli generalis defence, which was aimed at invalidating bad faith conduct. This opinion was criticised by the Harms DP in *Bredenkamp* supra note 52, however, in para 32.

<sup>61</sup> 2005 (3) SA 323 (SCA).

<sup>62</sup> *Ibid* para 26.

<sup>63</sup> *Ibid* para 31.

acknowledged that York had deliberately set out to frustrate SAFCOL's attempts to negotiate further, however.<sup>64</sup> The result was that York was held to be in breach of a duty not to frustrate SAFCOL in the exercise of its rights under the contract.<sup>65</sup> Although the existence of such a duty may have been ambiguous in terms of the actual contract, the 'underlying principles of good faith' required such an interpretation.<sup>66</sup>

The judgment in *SAFCOL v York* thus seems to imply a finding of bad faith conduct on the part of York by the Supreme Court of Appeal. Such an instance of bad faith, where a party refuses to negotiate with a counterpart after a preliminary agreement containing a duty to negotiate in good faith at a later date has been signed, or adopts stalling tactics deliberately to avoid reaching agreement, could also be outlawed on constitutional grounds. One could argue that the right to dignity,<sup>67</sup> or even to fairness itself,<sup>68</sup> has been infringed. The issue of whether or not there was an enforceable duty to behave in accordance with the dictates of good faith was not decided in *Barkhuizen*;<sup>69</sup> the focus was rather on the limitation of contractual freedom in the interests of public policy. With a bit of development, good faith or some other standard of objective reasonableness or fairness could, however, stand as an important underlying basis for any development of the law in the direction of enforcing a duty to negotiate in good faith.

Thus an objectively reasonable determination of an outstanding term should be available as an optional power to a court faced with a failure to negotiate in good faith. This would achieve for the parties what their failed negotiations should have resulted in. Such a power would be underpinned by the concept of good faith or public policy and this standard would inform the notion of determining an objectively reasonable term.

There is no direct authority for this proposition in South Africa, absent some sort of agreed upon deadlock-breaking provision. The preference contract may constitute an apt analogy, however, since it creates a condi-

<sup>64</sup> *Ibid* para 35.

<sup>65</sup> *Ibid* para 33.

<sup>66</sup> *Ibid* para 34.

<sup>67</sup> Section 10 of the Constitution. Gerhard Lubbe 'Taking fundamental rights seriously: the Bill of Rights and its implications for the development of contract law' (2004) 121 *SALJ* 395 discusses the tendency of the right to dignity to pull in two directions in the context of contracts (at 420–1). On the one hand dignity requires freedom of contract and 'the autonomous capacity to structure [one's] legal relations' and on the other it 'constrains' individual autonomy. This second sense of the right to dignity requires a contracting party to consider the circumstances and interests of his or her counterpart.

<sup>68</sup> For fairness as a constitutional value, see *Bredenkamp* *supra* note 52 para 27. See, however, the same judgment in para 50, where Harms DP stated that he did not believe that 'the enforcement of a valid contractual term must be fair and reasonable even if no public policy consideration found in the Constitution or elsewhere is implicated.'

<sup>69</sup> See *Barkhuizen* *supra* note 50 paras 79–82 and 120.

tional agreement to agree and appears to be enforceable.<sup>70</sup> Before formulating what could be a possible solution in the South African context as to how a duty to negotiate in good faith could be made enforceable, it is illuminating to consider the position in comparative jurisdictions and in certain supra-national bodies of contract law.

### III COMPARATIVE LAW ON 'DUTY TO NEGOTIATE IN GOOD FAITH' PROVISIONS

The issue of liability for breaking off contractual negotiations prior to finalising a contract is an area about which a considerable amount has been said in international jurisprudence. Germany has evolved a whole doctrine of pre-contractual liability, known as *culpa in contrahendo*. This liability lies somewhere between contract and delict and is today 'rationalised as a reliance-based relationship of "obligation imposed by law"'.<sup>71</sup> As regards a pre-contractual duty to negotiate in good faith in particular, Lorenz states that a party who wilfully causes damage to another in a manner which is *contra bonos mores* is bound to compensate him in German law.<sup>72</sup> He qualifies this rule by stating that breaking off contractual negotiations will not normally meet this stringent test.<sup>73</sup> The Reichsgericht did, however, support a few instances of such a claim based on *culpa in contrahendo*.<sup>74</sup> Lorenz states that this issue is less important in German law than in other systems, since an offer is generally binding on the offeror, unless he has excluded the binding effect thereof.<sup>75</sup> This latter type of revocable offer is hence regarded as merely an 'invitation to deal', upon which a party is unlikely to rely given its unenforceable nature.<sup>76</sup> A 'contract to make a contract' ('*Vorvertrag*') is recognised, however, provided certain essentials of the future main contract have been determined.<sup>77</sup> Before the stage of a *Vorvertrag* has been reached, a party is generally permitted to withdraw from negotiations, but not after.<sup>78</sup> The Bundesgerichtshof has continued the trend of the Reichsgericht in awarding reliance damages where a party 'in the course of negotiations has

<sup>70</sup> Compare Bhana *op cit* note 11.

<sup>71</sup> Basil Markesinis, Hannes Unberath & Angus Johnston *The German Law of Contract* (2006) 92. See also Arthur T von Mehren *International Encyclopedia of Comparative Law* (1976) VII ch 9, 23–8; Friedrich Kessler & Edith Fine 'Culpa in contrahendo, bargaining in good faith, and freedom of contract: a comparative study' (1964) 77 *Harvard LR* 401; John M Zieff 'Culpa in contrahendo — a prescription for the ills of the South African law of contract' (1989) 52 *THRHR* 348.

<sup>72</sup> Werner Lorenz 'Germany' in Ewoud H Hondius (ed) *Precontractual Liability — Reports to the XIIIth Congress, International Academy of Comparative Law* (1990) 159 at 165. See also Markesinis *et al op cit* note 52 at 99.

<sup>73</sup> Lorenz *ibid* at 165; Markesinis *op cit* note 71 at 99.

<sup>74</sup> *Ibid* at 166. Lorenz cites the following decisions of the Reichsgericht: 24 Feb 1931, RGZ 132, 26 (at 28–9) & 19 Jan 1934, RGZ 143, 219 (at 222).

<sup>75</sup> *Ibid*.

<sup>76</sup> *Ibid*.

<sup>77</sup> *Ibid*.

<sup>78</sup> *Ibid*.

made the other party believe that a contract will certainly be concluded, but then without good reason or from ulterior motives refuses to go ahead'.<sup>79</sup>

In the Netherlands the courts have used good faith in its objective sense (*redelijkheid en billijkheid*) to impose on a negotiating party a duty to take into account its opposing party's reasonable interests.<sup>80</sup> In *Plas v Municipality of Valburg*<sup>81</sup> a construction firm tendered for the building of a municipal swimming pool. There was no official tender process, but the mayor and his aldermen approved the proposal. The approval of the City Council remained outstanding, however. The Council ultimately approved a different tender at a lower price. The Hoge Raad held that where negotiations had reached the stage where both parties could reasonably assume that a contract would result, it would be against good faith to break off the relationship.<sup>82</sup>

In a case decided soon thereafter, the Hoge Raad held that where a preliminary agreement existed, the parties could be compelled to negotiate in good faith to finalise that agreement.<sup>83</sup> Specific performance could be awarded of the duty to negotiate in good faith.<sup>84</sup> In this case, an outstanding rental amount was supplied by the court to an otherwise complete preliminary agreement after a landlord had broken off negotiations.<sup>85</sup> As far as damages go, Van Dunné notes that Dutch courts are prepared to award the expectation measure of damages in appropriate cases.<sup>86</sup>

Common law legal systems are equally illuminating. In English law there have been attempts to make liability for breaking off negotiations fit under the banner of enrichment.<sup>87</sup> There are also suggestions that it should fall under estoppel or tort law.<sup>88</sup> As to the narrower issue of whether a duty to

<sup>79</sup> *Ibid.* Lorenz cites the following decisions of the Bundesgerichtshof: 10 July 1970, NJW 1970, 1840 & 12 June 1975 NJW 1975, 1774. See also Markesinis et al op cit note 71 at 100.

<sup>80</sup> Arthur S Hartkamp 'Judicial discretion under the new civil code of the Netherlands' (1992) 40 *American Journal of Comparative Law* 551 at 557. Jan M Van Dunné 'Netherlands' in Ewoud H Hondius (ed) op cit note 72 at 227 cites *Plas v Municipality of Valburg* Hoge Raad 18 June 1982, NJ 1983, 723 as the leading case in this regard.

<sup>81</sup> *Supra* note 80.

<sup>82</sup> The discussion of this case draws heavily on that of Van Dunné op cit note 80 at 230–231.

<sup>83</sup> *Koot BV v Koot BV* Hoge Raad 11 March 1983, NJ 585 cited in Van Dunné op cit note 80 at 231. Van Dunné discusses at 232–3 the further case of *VSH v Shell* Hoge Raad 23 October 1987, NJ 1988, 1017 to the effect that the freedom to break off negotiations may be barred once a certain stage in proceedings has been reached.

<sup>84</sup> *Ibid.*

<sup>85</sup> *Ibid.*

<sup>86</sup> *Ibid* at 234.

<sup>87</sup> *Regalian Properties Plc v London Docklands Development Corp* [1995] 1 WLR 212; *William Lacey (Hounslow) Ltd v Davis* [1957] 1 WLR 932; *Cobbe v Yeaman's Row Management Ltd* [2008] 1 WLR 1752. See Ewan McKendrick 'Work done in anticipation of a contract which does not materialize' in W R Cornish, Richard Nolan, J O'Sullivan & G Virgo (eds) *Restitution: Past, Present and Future* (1998) 163; Michael Furmston & G J Tolhurst *Contract Formation* (2010) chs 12 and 13.

<sup>88</sup> McKendrick op cit note 87 at 186.

negotiate in good faith clause is enforceable, the House of Lords has been very clear that this is a negative:

'[T]he 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.'<sup>89</sup>

English law would thus seem to be a dead end for comparative study on a duty to negotiate in good faith. Indeed the only authority for this proposition is an obiter dictum from a speech by Lord Wright in *Hillas & Co Ltd v Arcos Ltd*<sup>90</sup> which stated that provided there was good consideration, a contract to negotiate may be enforceable, though perhaps only by means of an award of nominal damages, 'unless a jury think that the opportunity to negotiate was of some appreciable value to the injured party'.<sup>91</sup>

Australian courts, by contrast, have been more willing to recognise a duty to negotiate in good faith. The leading case in this regard is *Coal Cliff Collieries (Pty) Ltd v Sijehama (Pty) Ltd*,<sup>92</sup> the case cited by the South African Supreme Court of Appeal in *Southernport Developments*.<sup>93</sup> In this case the duty to negotiate in good faith was found not to be part of a binding preliminary agreement.<sup>94</sup> It was encapsulated in a document headed, 'Heads of Agreement', which in the opinion of Kirby P contained too many 'blank spaces' for the court to enforce.<sup>95</sup> For this reason the duty was not enforced. Kirby P did approve the obiter dictum of Lord Wright in *Hillas v Arcos* mentioned above, to the effect that parties who have bound themselves to negotiate in good faith should be held to that promise, although he stated that the appropriate remedy may be nominal damages only.<sup>96</sup>

There are also several academic opinions on the topic of a contract to negotiate in good faith in Australia.<sup>97</sup> These go further than Kirby P on the issue of enforcement of such a duty, arguing for damages beyond a mere nominal measure. In this regard, Paterson opined as follows:

<sup>89</sup> *Walford v Miles* [1992] 2 AC 128 at 138. This confirmed the decision in *Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd* [1975] 1 WLR 297 and rejected the obiter dictum by Lord Wright in *Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503 at 515.

<sup>90</sup> *Supra* note 89.

<sup>91</sup> *Ibid* at 515.

<sup>92</sup> *Supra* note 6.

<sup>93</sup> *Supra* note 1.

<sup>94</sup> *Ibid* at 27.

<sup>95</sup> *Ibid*.

<sup>96</sup> *Ibid* at 25.

<sup>97</sup> J W Carter & M P Furmston 'Good faith and fairness in the negotiation of contracts' (1994) 8 *Journal of Contract Law* 1 and 93; Jeannie Marie Paterson 'The contract to negotiate in good faith: recognition and enforcement' (1996) 10 *Journal of Contract Law* 120; Ian B Stewart 'Good faith in contractual performance and in negotiation' (1998) 72 *Australian LJ* 370.

‘Generally the most appropriate measure of damages for breach of a contract to negotiate in good faith may be damages for the “loss of the chance” to conclude the negotiations successfully. Although the measure will, by definition, be somewhat speculative, it is consistent with the contract’s purpose. Parties to a contract to negotiate in good faith have contracted to reduce the risks of negotiation and for an improved chance successfully to conclude negotiations in a profitable transaction. In some cases, the possibility of “reliance damages” based on the plaintiff’s negotiation costs may alternatively be considered. Only where no ascertainable loss can be shown on any of these bases will nominal damages be appropriate.’<sup>98</sup>

Carter & Furmston, in a lengthy discussion of *Coal Cliff Collieries* and the relevant House of Lords decisions, state:

‘It is hard to feel that the House of Lords produced really conclusive reasons why parties who wish to assume mutual obligations to negotiate in good faith should be denied the court’s support in such a perfectly reasonable endeavour. . . . There may be specific cases in which a court cannot give effect to such a commitment, or where the damages are only nominal, but it is over simplistic to assume all cases are of this kind.’<sup>99</sup>

The Australian courts and commentators seem to draw quite heavily on American authorities in this regard. Kirby P in *Coal Cliff Collieries* noted that far more cases of failed negotiation had come before American courts than those of Australia or England and that this had given rise to a considerable body of academic commentary in the United States, to which he referred.<sup>100</sup> The leading case in the United States on liability for breaking off negotiations is *Hoffman v Red Owl Stores*.<sup>101</sup> Although this case did not involve a duty to negotiate in good faith clause, it presents an interesting study in the issues surrounding reliance on pre-contractual promises. This is a broader question than where a preliminary agreement is present. In this broader type of scenario there is as-of-yet no contract, meaning a plaintiff must rely on some other cause of action when claiming reliance damages for bad faith conduct on the part of his opposing party.

In this case Hoffman was given assurances by Red Owl Stores that if he had a certain amount of capital he could set up a supermarket using its franchise. He expended considerable sums and a large amount of time and energy in reliance on these assurances, only to have Red Owl move the goal posts at the last minute and require a greater capital contribution than he could afford. The Supreme Court of Wisconsin ultimately held Red Owl

<sup>98</sup> Paterson op cit note 97 at 139.

<sup>99</sup> Carter & Furmston op cit note 97 at 115.

<sup>100</sup> *Coal Cliff Collieries* supra note 6 at 22.

<sup>101</sup> 133 NW 2d 267 (Wisconsin 1965). For a lengthy discussion of this case see Robert E Scott ‘*Hoffman v Red Owl Stores* and the myth of precontractual reliance’ (2007) 68 *Ohio State LJ* 71.

liable on the basis of promissory estoppel<sup>102</sup> and awarded reliance damages to Hoffman.<sup>103</sup>

In the Hoffman case there was no express ‘duty to negotiate in good faith’ clause, however. In a treatise on the subject, Farnsworth concurs that breach of such a duty to negotiate in good faith should lead to a claim for reliance damages, which appears to be a generally accepted view amongst commentators in the United States.<sup>104</sup> Farnsworth cites *Itek Corporation v Chicago Aerial Industries*<sup>105</sup> as an example of a case involving a more concrete preliminary agreement where a court was willing (at least in principle) to enforce a duty to negotiate in good faith.<sup>106</sup> Here the parties had signed a letter of intent to sell the assets of CAI to Itek, which contained several terms, including the sales price. A final contract was envisaged in this letter, but was never completed. CAI then tried to back out of the deal. The Supreme Court of Delaware held that CAI had breached this letter, ‘by wilfully failing to negotiate in good faith toward the completion of the deal’.<sup>107</sup> An outstanding question, however, was whether on the facts the letter of intent constituted a binding agreement.<sup>108</sup> The court came to the conclusion that the letter did not constitute a binding contract, but left open the question as to whether in the event that Itek had been able to establish CAI’s liability it would be able to proceed against its stockholders.<sup>109</sup>

Farnsworth also states that where there are open terms in an agreement, the duty to negotiate further in good faith may be implied.<sup>110</sup> He links this to a discussion of an objective duty of good faith in negotiating open terms — the duty of ‘fair dealing’ — which he claims extends to all such terms.<sup>111</sup> Summers also describes various forms of bad faith conduct which can be manifested at the negotiation stage of a contract, although he notes that good faith conduct is not always enforced by the courts in this setting.<sup>112</sup> This is

<sup>102</sup> The basis of this finding was § 90 of the *Restatement, Second, Contracts* (1981).

<sup>103</sup> *Hoffman* supra note 101 at 274–7.

<sup>104</sup> E Allan Farnsworth ‘Precontractual liability and preliminary agreements: fair dealing and failed negotiations’ (1987) 87 *Columbia LR* 217 at 255. See also Charles L Knapp ‘Enforcing the contract to bargain’ (1969) 44 *New York University LR* 673 at 723; Alan Schwartz & Robert E Scott ‘Precontractual liability and preliminary agreements’ (2006–2007) 120 *Harvard LR* 661 at 664–5.

<sup>105</sup> 248 A 2d 625 (Delaware 1968) at 629.

<sup>106</sup> Farnsworth op cit note 104 at 265.

<sup>107</sup> *Itek* supra note 105 at 628.

<sup>108</sup> *Ibid* at 629.

<sup>109</sup> *Ibid* at 630–1.

<sup>110</sup> *Ibid* at 254–5. Farnsworth notes that this is not accepted in all states. An example of a case supporting this proposition (which he cites) is *Teachers Insurance & Annuity Association of America v Butler* 626 F Supp 1229 (New York 1987) at 1232. See also Schwartz & Scott op cit note 104 at 664; Scott op cit note 101 at 98–101.

<sup>111</sup> Farnsworth op cit note 104 at 268.

<sup>112</sup> Robert S Summers ‘“Good faith” in general contract law and the sales provisions of the Uniform Commercial Code’ (1968) 54 *Virginia LR* 195 at 220.

echoed by Farnsworth, although he claims that a party may have an action for restitution or misrepresentation under such circumstances.<sup>113</sup>

A synopsis of the United States law in this area shows certain broad trends. Reliance damages may be available for failure to negotiate in good faith over open terms, even in the absence of such an express clause in the contract. Whether any measure of damages is available beyond this is debatable, but in appropriate circumstances a party may be guilty of bad faith conduct for a failure to negotiate in good faith. This may lead to a remedy of damages, whether in contract, delict, estoppel or enrichment.

The final comparative excursus undertaken here will be into the realm of supra-national contract rules, particularly the Unidroit Principles of International Commercial Contracts. Article 2.1.15 (Negotiations in bad faith) reads as follows:

- (1) A party is free to negotiate and is not liable for failure to reach an agreement.
- (2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.
- (3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.'

Comment 2 to this provision notes that a party's right to negotiate must be exercised in accordance with the duty of good faith and fair dealing contained in art 1.7. This comment continues to the effect that liability for negotiating in bad faith is limited to reliance damages, but states that if the parties have expressly agreed on a duty to negotiate in good faith, all the remedies for breach of contract will be available to them, including the right to performance. Illustration four contains an example of a 'pre-bid agreement' between a contractor and a supplier, which includes a duty to negotiate in good faith clause. If the contractor refuses to continue negotiations after the award of the contract, the supplier may request enforcement of the duty to negotiate in good faith.

Kleinheisterkamp notes that pre-contractual liability is a sensitive issue in comparative law and that art 2.1.15 of the PICC 'can hardly be said to restate a general principle of law'.<sup>114</sup> However, since the threshold for application of the article is 'bad faith' he feels that this provision should be acceptable to most countries.<sup>115</sup> This more restrictive standard is preferable he feels to the

<sup>113</sup> Ibid at 285.

<sup>114</sup> Jan Kleinheisterkamp 'Formation and authority of agents' in Stefan Vogenauer & Jan Kleinheisterkamp (eds) *Commentary on the Unidroit Principles of International Commercial Contracts (PICC)* (2009) 215 at 300. Compare the discussion of English law above, where the existence of a duty to negotiate in good faith is expressly denied.

<sup>115</sup> See the Opinion (31 January 2002) of the Advocate General Geelhoed, Court of Justice of the European Communities, *Fonderie Officine Meccaniche Tacconi Spa v Heinrich Wagner Sinto Maschinenfabrik GmbH* paras 55–63. This case is available at [www.unilex.info](http://www.unilex.info), accessed on 26 May 2010. Here Geelhoed takes art 2.1.15 as his starting

phrasing of the equivalent provision of the Principles of European Contract Law, which enforces a standard of good faith.<sup>116</sup> As far as the enforcement of a duty to negotiate in good faith goes, Kleinheisterkamp states as follows:

'If a party does not make the efforts that a reasonable person would make to overcome unforeseen obstacles in order to reach an agreement, it acts in bad faith (as defined by the parties) and will be liable for the reliance damages of the other party under Art 2.1.15(2). In contrast, specific performance in the sense of sending the recalcitrant party back to the negotiating table is not possible (Art 7.2.2(d)).'<sup>117</sup>

Farnsworth echoes this interpretation that art 2.1.15 can give rise only to reliance damages, based on the use of the word 'losses' in art 2.1.15(2).<sup>118</sup> The inclusion of 'losses' by implication excludes 'gains' which would entail the expectation interest.<sup>119</sup>

In *Fonderie Officine Meccaniche Tacconi Spa v Heinrich Wagner Sinto Maschinenfabrik GmbH*,<sup>120</sup> a case heard in 2002 by the Court of Justice of the European Communities, the issue of liability for breaking off negotiations was discussed. Advocate Geelhoed, who decided the case, discussed the relevant law of several member states, but started with the provisions of article 2.1.15 of the Unidroit Principles.<sup>121</sup> The *Tacconi* decision thus seems to accept the Unidroit provision as representing a compromise on the issue of liability for breaking off negotiations prior to contracting.<sup>122</sup> This is confirmed by the brief excursus of the German, Dutch, United States and

point for liability for breaking off negotiations, in a case involving European parties. Kleinheisterkamp op cit note 114 at 300 interprets this use of the Unidroit Principles as a view that they are general law acceptable to most parties. For a similar conclusion see Olaf Meyer 'The Unidroit Principles and their impact on European private law' (2002) 7 *Uniform LR* 1222 at 1223.

<sup>116</sup> Kleinheisterkamp op cit note 114 at 302. PECL Article 2:301 (Negotiations contrary to good faith) reads as follows:

- (1) A party is free to negotiate and is not liable for failure to reach an agreement.
- (2) However, a party which has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party.
- (3) It is contrary to good faith and fair dealing, in particular, for a party to enter into or continue negotiations with no real intention of reaching an agreement with the other party.'

See Ole Lando and Hugh Beale (eds) *Principles of European Contract Law* Parts I & II (2000).

<sup>117</sup> *Ibid* at 305. Kleinheisterkamp adds in a footnote that Illustration 4 (discussed above) is thus misleading when it states that the supplier 'may request enforcement of the duty to negotiate in good faith'.

<sup>118</sup> E Allan Farnsworth 'Duties of good faith and fair dealing under the Unidroit Principles, relevant international conventions and national laws' (1995) 3 *Tulane Journal of International & Comparative Law* 47 at 58–9.

<sup>119</sup> *Ibid*.

<sup>120</sup> *Supra* note 115.

<sup>121</sup> *Ibid* at para 55.

<sup>122</sup> See the views on this point set out in note 115.

Australian law on point undertaken above. Hence, while hard bargaining is permitted, bad faith negotiation is not. Similarly, reliance damages are recoverable in appropriate circumstances, but the expectation interest is not. It would also seem to be general that specific performance is not available as a remedy for breach of a duty to negotiate in good faith. The English view that no duty to negotiate in good faith can exist appears to be an isolated one, and a general duty of objective good faith (or fair dealing) — or at the very least a prohibition of bad faith conduct — seems to pertain to the negotiation of contracts in most of the countries examined here.

The tendency of the South African Supreme Court of Appeal to draw on foreign law in this area has been demonstrated by the extensive reference to the Australian case of *Coal Cliff Collieries in Southernport Developments*. The jurisprudence set out in this brief survey can now inform a discussion of possible avenues of development of South African law on ‘duty to negotiate in good faith’ clauses. The focus herein has been on methods by which such a duty can be enforced in foreign law and this focus will now be brought to bear on South African law. This paper will also attempt to show why South African law is different to that of the jurisdictions discussed above and hence why specific performance of a duty to negotiate in good faith clause should be enforceable in our law.

#### IV ENFORCEMENT OF A DUTY TO NEGOTIATE IN GOOD FAITH IN SOUTH AFRICAN LAW

Freedom of contract remains a foundational value in the South African legal system<sup>123</sup> and its protection is in the interests of commercial growth. The ability of a party to drive a hard bargain — and to threaten to withdraw from negotiations prior to their completion to achieve this end — leads to sound business practice and is attractive to potential investors. This freedom should remain in commercial dealings and should not be unnecessarily fettered. To this extent, the statement of the House of Lords in *Walford v Miles* (quoted above) can be endorsed. Hard bargaining must be distinguished, however, from bad faith conduct, which is not acceptable in South African law.<sup>124</sup> The *Barkhuizen* case sets a requirement of balancing the competing values of contractual freedom and considerations of fairness against each other, so that contractual terms which are unfair, unjust or unreasonable would be against public policy and hence invalid.<sup>125</sup> According to that case, public policy is also aimed at doing ‘simple justice between individuals’.<sup>126</sup> While the status of an enforceable duty of good faith, to the extent that this represents

<sup>123</sup> *Barkhuizen v Napier* supra note 50 para 57.

<sup>124</sup> See generally *Barkhuizen* ibid, particularly paras 69–70; *Breedenkamp v Standard Bank of SA Ltd* 2009 (5) SA 304 (GJ); *Breedenkamp v Standard Bank of SA Ltd* 2009 (6) SA 277 (GJ); *Breedenkamp v Standard Bank of SA Ltd* supra note 52; Glover op cit note 55 and Kerr op cit note 55.

<sup>125</sup> *Barkhuizen* supra note 50 paras 28–30, 51.

<sup>126</sup> Ibid para 51.

something different from public policy, remains uncertain,<sup>127</sup> bad faith conduct would quite clearly fall foul of the public policy rule as set out above. While the *Barkhuizen* case was concerned with the validity of a contractual term, rather than the negotiation of contracts, it would not be a major leap, given the definition of public policy in that case, to outlaw bad faith conduct during negotiations.

What remains therefore, given the generality of the *Barkhuizen* definition of public policy, is to identify examples of bad faith conduct in the negotiation phase. Article 2.1.15(3) of the Unidroit Principles gives the example of entering into or persisting in negotiations without the intention of reaching agreement. A South African case example of this type of scenario would be *SAFCOL v York* as discussed above.<sup>128</sup> The acceptance of a duty not to frustrate SAFCOL's attempts to adjust the price in that case, seems to imply an endorsement by the Supreme Court of Appeal of branding York's conduct unacceptable. Although good faith formed a part of the basis of this decision, the real problem was a deliberate avoidance by York of its obligations. This type of deliberate intent seems to be the clearest example of bad faith. A further example may be 'the use of unlawful economic pressure'<sup>129</sup> in exploiting an advantage over an opposing party (a situation commonly referred to as economic duress) to extract a favourable price or terms upon renegotiation.

To attempt to impose an objective standard of good faith bargaining, rather than outlawing bad faith, may, however, impinge upon legitimate hard bargaining to too great an extent. Compare in this regard the instances which Farnsworth identifies as bad faith: refusal to negotiate further, improper tactics (in the sense of hard bargaining which is unreasonable), non-disclosure of material facts (to the extent that there is a duty to disclose), negotiation with third parties and reneging on promises already exacted.<sup>130</sup> Several of these could well be defended as hard bargaining rather than bad faith conduct. Clearly a distinction must be carefully drawn here and this seems to rest, as in Unidroit's example, on a deliberate intention to string the other party along without intending to agree. Seen in this light, something akin to *dolus* is required before bad faith can be said to be present. The same would be true of a situation where economic duress is employed to achieve favourable terms. Identifying an instance of bad faith conduct whether at the performance or negotiation phase of contracting will ultimately be a question of fact and this determination will be based on the general guidelines as to what public policy entails in this setting. Given the notion of the freedom not

<sup>127</sup> *Ibid* para 83.

<sup>128</sup> See part II of this article above.

<sup>129</sup> Graham Glover 'Developing a test for economic duress in the South African law of contract: a comparative perspective' (2006) 123 *SALJ* 285 at 285. See this article for a helpful account of the doctrine of economic duress and an analysis of South African and foreign cases in point.

<sup>130</sup> Farnsworth *op cit* note 104 at 273–85. See also Summers *op cit* note 112 at 220–32.

to contract,<sup>131</sup> however, bad faith should be clearly demarcated from hard bargaining.

A more difficult question in the context of a duty to negotiate is how does a court make the leap from identifying bad faith negotiating tactics to enforcing this duty on the recalcitrant party? Clearly this is a different situation from that envisaged in *Barkhuizen*, since the contract terms are not under threat. Rather the court is called upon to censure conduct. Nominal damages, in the sense of providing a token to a party which has proven breach, but has not been able to prove contractual loss are not available in South African law.<sup>132</sup> Thus the primary remedy envisaged by Lord Wright in *Hillas v Arcos* and by Kirby P in *Coal Cliff Collieries* is unavailable to South African litigants. This worthless remedy would in any event be a pyrrhic victory to a party who has been denied the opportunity to contract by a bad faith refusal of its counterpart to negotiate.

The obvious solution, if the court deems such conduct wrongful is to award damages in delict. Here a party's pre-contractual reliance could be compensated if its counterpart breaks off negotiations in bad faith. No duty to negotiate in good faith clause is then required, merely some sort of representation by the defendant which gave rise to the plaintiff's reliance. An international example of such a case would be *Hoffman v Red Owl Stores*,<sup>133</sup> discussed above.<sup>134</sup> There is little South African authority on this point. See, however, in the context of non-disclosure, the statements of Jansen J in *Meskin NO v Anglo American Corporation of SA Ltd*<sup>135</sup> that bad faith conduct constituted fraud<sup>136</sup> for which there was an action in delict<sup>137</sup> and that the duty of good faith extended into the pre-contractual phase.<sup>138</sup>

A case from the former Rhodesia, *Murray v McLean NO*,<sup>139</sup> is more in point. Here a manufacturer of prefabricated housing was offered a contract to produce 52 houses for the government. The plaintiff manufacturer relied on the representations of various government officials that the houses were urgently required, spending money on materials as well as foregoing other contracts. It later transpired that the relevant Ministry did not have sufficient funds to pay for the houses and the contract was thus never finalised. The plaintiff sued for its reliance damages based on negligent misstatement. The

<sup>131</sup> See Bhana op cit note 11 at 582 who describes this as the corollary of freedom of contract.

<sup>132</sup> Christie op cit note 9 at 548; Schalk van der Merwe, L F van Huyssteen, M F B Reinecke & G F Lubbe *Contract — General Principles* 3 ed (2007) 416.

<sup>133</sup> 133 NW 2d 267 (Wisconsin 1965).

<sup>134</sup> It will be recalled, however, that the basis of the award of damages in this case was promissory estoppel, rather than delict.

<sup>135</sup> 1968 (4) SA 793 (W). Compare the statement in *Savage and Lovemore Mining (Pty) Ltd v International Shipping Co (Pty) Ltd* 1987 (2) SA 149 (W) at 198A–B.

<sup>136</sup> *Meskin NO* supra note 135 at 802A–B.

<sup>137</sup> *Ibid* at 798F.

<sup>138</sup> *Ibid* at 804D.

<sup>139</sup> 1970 (1) SA 133 (R).

court held that the Executive must be free to act in the best interests of the community when allocating public funds and that the plaintiff accordingly had no right to rely on the representations of government officials.<sup>140</sup> It was held that the plaintiff had no cause of action and that its pleas therefore failed.<sup>141</sup>

Despite the contrary finding in *Murray v McLean NO*,<sup>142</sup> the delictual action seems most appropriate in the absence of a binding preliminary agreement to discourage bad faith breaking off of negotiations. An award of reliance damages on this basis appears to be in line with most of the comparative jurisdictions studied above.<sup>143</sup> Given that pure economic loss is actionable in the South African law of delict<sup>144</sup> and this extends to negligent misrepresentation,<sup>145</sup> negative interest damages should be claimable in this manner provided the elements of the delictual action can be proven.

Of course if there is a duty to negotiate in good faith clause contained in a binding preliminary agreement, then a contractual remedy is also possible. It seems to be clear that it is possible to claim reliance damages in contract.<sup>146</sup> Thus a plaintiff may claim to the extent that he has altered his position to his detriment in reliance on the contract, including consequential losses.<sup>147</sup> Such a claim may not, however, exceed the positive interest which the plaintiff stood to make on the contract.<sup>148</sup> This would also compensate the innocent party for his out-of-pocket losses, following a breaking off of negotiations in bad faith.

<sup>140</sup> Ibid at 141A.

<sup>141</sup> Ibid at 142B–D. This decision was approved by P Q R Boberg in the 1970 *Annual Survey of South African Law* 159–60. W H B Dean ‘Put not your trust in princes, nor in the son of man, in whom there is no help Psalm 146, Verse 3’ (1970) 87 *SALJ* 149 had a different opinion. Dean states (at 155–6) that as a matter of course business people do enter into transactions based on trust and hence that in a case such as this there should be a possibility of a delictual action. See also the discussion of this area of the law in Dale Hutchison ‘Good Faith in the South African Law of Contract’ in Brownsword, Hird & Howells (eds) *Good Faith in Contract: Concept and Context* op cit note 55 at 236–42.

<sup>142</sup> Supra note 139.

<sup>143</sup> Compare the *Tacconi* case supra note 115 para 76 where Advocate Geelhoed held that under certain circumstances bad faith conduct at the negotiation stage of a contract could constitute a delict or quasi-delict.

<sup>144</sup> *Hefer v Van Greuning* 1979 (4) SA 952 (A); *Indac Electronics (Pty) Ltd v Volkskas Bank Ltd* 1992 (1) SA 783 (A); *Trustees, Two Oceans Aquarium Trust v Kantey & Templer (Pty) Ltd* 2006 (3) SA 138 (SCA); J Neethling, J M Potgieter & J C Knobel *Law of Delict* (2010) at 10 and 290; Max Loubser & Rob Midgley (eds) *The Law of Delict in South Africa* (2009) at 224–9.

<sup>145</sup> *Administrateur, Natal v Trust Bank van Afrika Bpk* 1979 (3) SA 824 (A).

<sup>146</sup> *Probert v Baker* 1983 (3) SA 229 (D); *Mainline Carriers (Pty) Ltd v Jaad Investments CC* 1998 (2) SA 468 (C); Gerhard Lubbe ‘The assessment of loss upon cancellation for breach of contract’ (1984) 101 *SALJ* 616; Dale Hutchison ‘Back to basics: reliance damages for breach of contract revisited’ (2004) 121 *SALJ* 51.

<sup>147</sup> Hutchison ibid at 56.

<sup>148</sup> *Mainline Carriers* supra note 146 paras 53–7; Lubbe op cit note 146 at 627.

As to an award of expectation interest damages for failure to comply with a duty to negotiate in good faith, in the sense of awarding foreseeable gains as well as reliance based losses, this could be more problematic. Although a binding preliminary agreement may have been concluded, the existence of open terms may make it difficult to prove what the ultimate gains may have been. It is no doubt for this reason that most foreign jurisdictions, with the exception of the Netherlands,<sup>149</sup> refuse to make such an award.

The safe answer to the enforceability question is thus that an action for reliance damages should exist in the instance of bad faith conduct by the recalcitrant party. Whether this action is in contract or in delict will depend upon whether there is a binding preliminary agreement containing a duty to negotiate in good faith. What this ignores, however, is the simplicity of the remedy ultimately made in the *Southernport Developments* case. As long as there was an arbitration provision in the contract, the court was safe to hold that the open terms be resolved by this third party, secure in the knowledge that it was not making a contract itself for the parties and thereby not unacceptably impinging upon freedom of contract.

However, can the case law on fettering the exercise of unilateral contractual powers to an objective standard of reasonableness not be adapted to fit this type of situation? Compare with this the strong suggestion that under a contract of first refusal the grantor of the preferential right is obliged to make a bona fide offer to the grantee should she form an intention to sell. In the first context an open term is determined by reference to an external standard by a party and in the second this is imposed on a party by a court.<sup>150</sup> What if, absent an arbitration clause, but in the presence of a binding preliminary agreement containing an open term which is readily ascertainable by reference to external standards, such as a market-related price, a court were to order that the parties go away and agree on an independent arbitrator to determine the outstanding term?<sup>151</sup> As discussed above, this is similar to the position enforced by the Hoge Raad of the Netherlands. Instead of the court determining the outstanding term itself, which would perhaps be going too far,<sup>152</sup> it merely cures the omission of the parties to include a deadlock-breaking provision.

Admittedly, this is a drastic step, but it would grant a tangible and credible sanction to what is otherwise a toothless duty to negotiate. Furthermore, if we are to accept that a failure to negotiate under these circumstances would

<sup>149</sup> See the discussion in part III of this article above.

<sup>150</sup> The agreement in *Soteriou* supra note 9 required a rental and possibly further relevant terms and conditions to be fixed (at 929) and was held by the majority of the Appellate Division to constitute a valid and enforceable right of first refusal (at 935A). As such there was a binding preliminary agreement and no initial offer was required.

<sup>151</sup> One might quote as authority here the cases on the exercise of a contractual power *arbitrium boni viri* or those which state that a preference agreement may be enforced by specific performance.

<sup>152</sup> Compare the finding in *H Merks & Co (Pty) Ltd v The B-M Group (Pty) Ltd* supra note 17 at 235C–D.

amount to a breach of an enforceable contractual duty, this would enable the enforcement of the innocent party's right to specific performance, which is the primary remedy for breach of contract in South Africa.<sup>153</sup> If contractual relief is to be given to the innocent party, it would be unusual to award him damages alone, without resort to specific performance. Should the court exercise its discretion not to award specific performance, the objectively reasonable determination of the outstanding term would permit the quantification of expectation interest damages as well. Seen in this light, a duty to negotiate in good faith clause is enforceable, even in the absence of an arbitration clause, provided the preliminary agreement in which it is contained is binding and the open term(s) left to be negotiated are capable of being resolved in this manner.

## V CONCLUSION

Comparative study reveals that in some jurisdictions it has been accepted for some time that liability for bad faith conduct stretches into the negotiation phase, prior to the finalisation of an ultimate contract. In the common law world, the United States and, to a certain extent, Australia accept this principle. The exact doctrinal nature of the liability varies between jurisdictions and is the subject of a certain amount of debate, but the availability of reliance damages does seem to be established. Civil law countries adopt different enforcement techniques but liability seems likewise to be recognised, certainly in Germany and the Netherlands. Indeed the generality of the availability of damages for bad faith negotiation is demonstrated by the inclusion of such a rule in Unidroit Principles.

In South Africa, damages for bad faith negotiation have not as yet been firmly established. The aim of this article was to explore the law surrounding a pre-contractual duty to negotiate in good faith, particularly as contained in preliminary agreements. The Supreme Court of Appeal has clearly ruled that such a clause is binding if it is accompanied by some sort of deadlock-breaking provision, such as an arbitration clause. Also if the preliminary arrangement in which such a duty is said to exist does not constitute a binding contract, there is clear authority that no obligation to negotiate further in good faith exists.

With regard to comparative law, it is easy to defend an argument that reliance damages for bad faith breaking off of negotiations should be available to an aggrieved party in South African law. The grey area in this regard is where there is a binding preliminary agreement containing an open term or terms as to, for example, a sale price or rental amount. Under such circumstances a duty to negotiate in good faith should be enforced if expressly included and perhaps even should constitute an implied term in a preliminary agreement where it is not included. Should a recalcitrant party persist in bad faith to refuse to negotiate at a later stage, this duty should be

<sup>153</sup> *Benson v SA Mutual Life Assurance Society* 1986 (1) SA 776 (A) at 782–3.

enforceable upon him or her. A court should be able to compel such a party to negotiate in good faith, perhaps even under threat of possibly appointing an arbitrator to supply such an outstanding term. The arbitrator's exercise of this power would have to measure up to standards of objective reasonableness and the term supplied would thus be such as would have been reached had the negotiations proceeded in good faith. This will give a credible sanction to the duty to negotiate in good faith and would ensure that the dictates of public policy and fair dealing are realized.