Pre-Contractual Agreements

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Abstract

As modern commercial transactions become larger and more complex, business professionals have resorted to various instruments or agreements aimed at regulating and progressing the negotiation process. Some of these instruments can even strongly resemble a contract, but are preliminary in form, and as such give rise to uncertainty as to their enforceability. The diverse range of agreements concluded prior to a principal contract, which may be termed pre-contractual agreements, are the focus of critical examination in this thesis.

The nature and legal consequences of pre-contractual agreements are both uncertain and controversial. This is in large part due to the fact that the term “pre-contractual” does not refer to a specific type of agreement with a standardised legal content but rather to the stage at which the agreement is concluded. In this thesis, the various types of pre-contractual agreements are catergorised according to their function so as to establish which of these agreements, if any, meet the validity requirements for a contract and thus give rise to legal consequences. Particular focus is placed on the legal nature and consequences of various types of agreements to negotiate.

Due to the limited local case law and academic literature on pre-contractual agreements and the broader topic of pre-contractual liability, comparative observations can form a central component in the formulation of potential solutions to the obstacles presented by these agreements. With the benefit of comparative analysis the conclusion is reached that a sound framework to regulate the pre-contractual phase can be established through the development of the law of contract to enforce specific types of agreements to negotiate.

To analyse all the potential legal consequences arising from pre-contractual agreements comprehensively, the scope of the analysis extends beyond the law of contract to consider the potential remedies that may lie in other sources of law, such as the law of delict and the law of unjustified enrichment. The conclusion is reached that both the law of delict and the law of unjustified enrichment can serve as valuable sources of pre-contractual liability to rectify potential injustices that may arise during the presently unregulated pre-contractual phase.

Opsomming

Namate moderne kommersiële transaksies groter en meer ingewikkeld geword het, het sakelui verskillende instrumente of ooreenkomste begin gebruik om die onderhandelingsproses te reguleer. Sommige van hierdie instrumente kan selfs sterk ooreenkomste met ‘n kontrak vertoon, maar weens hulle voorlopige aard heers daar onsekerheid oor hul afdwingbaarheid. Die fokus van hierdie tesis is die uiteenlopende groep ooreenkomste wat as ‘voor-kontraktuele ooreenkomste’ beskryf kan word omdat hulle tot stand kom voordat ‘n hoofkontrak tot stand kom.

Die aard en regsgevolge van voor-kontraktuele ooreenkomste is onseker en omstrede. Die onsekerheid onstaan grootliks omdat die begrip “voor-kontraktueel” nie na ‘n spesifieke tipe ooreenkoms met ‘n standaard regsinhoud verwys nie, maar eeder na die stadium waarop die ooreenkoms tot stand kom. In hierdie tesis word die verskillende tipes voor-kontraktuele ooreenkomste volgens funksie gekategoriseer om te bepaal watter van hierdie ooreenkomste, indien enige, aan die geldigheidsvereistes van ‘n kontrak voldoen en sodoende regsgevolge sal hê. Die aard en regsgevolge van “ooreenkomste om te onderhandel” is hier van spesifieke belang.

Weens die beperkte omvang van plaaslike regspraak en akademiese literatuur oor voor-kontraktuele ooreenkomste, asook die breër onderwerp van voor kontraktuele aanspreeklikheid, kan regsvergelykende perspektiewe nuttig wees om ‘n raamwerk te skep waarbinne die regulering van die voor-kontraktuele fase hanteer kan word. Die kontraktereg kan sodoende uitgebrei word om sekere tipes “ooreenkomste om te onderhandel” afdwingbaar te maak.

Selfs ‘n meer uitgebreide kontrakteregbedeling sal egter nie voldoende wees om al die moontlike regsgevolge van voor-kontraktuale ooreenkomste omvattend te ontleed nie. Ander regsgebiede, naamlik die deliktereg en die verrykingsreg, moet ook betrek word by die ondersoek. Die gevolgtrekking word bereik dat die deliktereg sowel as die verrykingsreg as waardevolle bronne van voor-kontraktuele aanspreeklikheid kan dien. Sodoende kan gebreke in die ongereguleerde voor-kontraktuele fase reggestel word.

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List of abbreviations

ACC	Association of Corporate Counsel
Am J Comp L	*American Journal of Comparative Law*
ARELJ	*Australian Resources and Energy Law Journal*
ASR	*American Sociological Review*
BGB	*Bürgerliches Gesetzbuch* (German Civil Code)
BGH	*Bundesgerichtshof* (Federal Court of Justice)
BLI	*Business Law International*
BLR	*Business Law Review*
Chi-Kent L Rev	*Chicago-Kent Law Review*
CISG	United Nations Convention on Contracts for the International Sale of Goods
CLJ	*Cambridge Law Journal*
Colum LR	*Columbia Law Review*
Constr Law	*Construction Law Journal*
DCFR	Draft Common Frame of Reference
EC	European Commission
ESJ	*European Scientific Journal*
Fordham L Rev	*Fordham Law Review*
Franchise LJ	*Franchise Law Journal*
Geo Wash J Int'l L & Econ	*Goerge Washington Journal of*

	International Law and Economics
Gonz L Rev	*Gonzaga Law Review*
Harv L Rev	*Harvard Law Review*
Hous J Int'l L	*Houston Journal of International Law*
ICLQ	*International & Comparative Law Quarterly*
IJLMA	*International Journal of Law and Management*
Int'l Bus LJ	*International Business Law Journal*
J Law & Soc	*Journal of Law and Society*
LAWSA	*Law of South Africa*
Legal Stud	*Journal of Legal Studies*
LMCLQ	*Lloyd's Maritime and Commercial Law Quarterly*
LQR	*Law Quarterly Review*
Maastricht J Eur & Com L	*Maastricht Journal of European and Comparative Law*
Macquarie J Bus L	*Macquarie Journal of Business Law*
Negotiation J	*Negotiation Journal*
NTU L Rev	*National Taiwan University Law Review*
NWJILB	*Northwestern Journal of International Law and Business*
NYU J L & Bus	*New York University Journal of Law & Business*
NYU L Rev	*New York University Law Review*

Ohio ST LJ	*Ohio State Law Journal*
Oxford J Legal Stud	*Oxford Journal of Legal Studies*
OUCLJ	*Oxford University Commonwealth Law Journal*
PECL	Principles of European Contract Law
PER	*Potchefstroom Electronic Law Journal*
PICC	UNIDROIT Principles of International Commercial Contracts
Real Prop Prob & Tr J	*Real Property, Probate and Trust Journal*
RLR	*Restitution Law Review*
SALJ	*South African Law Journal*
SAPL	*South African Public Law*
SJ	*Speculum Juris*
SMU L Rev	*Southern Methodist University Law Review*
Stell LR	*Stellenbosch Law Review*
Syracuse L Rev	*Syracuse Law Review*
Tel Aviv U Stud	*Tel Aviv University Studies in Law*
THRHR	*Tydskrif vir Hedendaagse Romeins-Hollandse Reg*
Tul Eur & Civ LF	Tulane European and Civil Law Forum
U Pa LR	*University of Pennsylvania Law Review*
Tas L Rev	*University of Tasmania Law Review*

U Toronto Fac L Rev	*University of Toronto Faculty of Law Review*
UC Davis Bus LJ	*University of California Davis Business Law Journal*
UCLA L Rev	*University of California Los Angeles Law Review*
UNIDROIT	International Institute for the Unification of Private Law
Va LR	*Virginia Law Review*
Yale LJ	*Yale Law Journal*

Table of contents

Chapter 1: Introduction

1 1 The commercial use of pre-contractual agreements

Business professionals at times conclude agreements to outline the terms and structure of an envisaged transaction. If one of the parties ultimately does not continue with concluding a deal, the question arises as to the legal consequences (if any) of these preliminary agreements. Preliminary agreements are often of a hybrid nature and consist of binding and non-binding terms. The uncertainty around these agreements is exacerbated by the fact that business professionals often are not concerned at the time of conclusion of the agreement with painstakingly distinguishing legal obligations from non-binding terms facilitating the negotiation; their concern is rather merely with using whichever instrument proves most useful in taking the transaction forward.

As business transactions have become more complex, the need has increased for these types of instruments that outline the envisaged transaction and regulate the relationship between commercial parties before the principal contract is concluded.[1] At the outset it is often not possible for parties to conclude a complete contract, and the only option then is to enter into some form of pre-contractual arrangement, especially where expenses will be incurred pursuant to the proposed transaction. It is common practice in large and complex negotiations involving a number of parties to conclude a range of preliminary agreements prior to the main contract.

These agreements are described in various ways, including a “Letter of Intent”, “Heads of Agreement”, “Memorandum of Understanding” (MOU), “Memorandum of Agreement” (MOA), and “Agreement in Principle”.[2] The numerous names given to these pre-contractual agreements are often used interchangeably. It is difficult to assess the legal consequences of pre-contractual agreements because their content and functions can differ so vastly, and no specific legal effect can be attached to the agreement solely on the basis of its name.[3] For purposes of this thesis, a neutral term,

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[1] C Kunze *The Letter of Intent, with Special Emphasis on its Relevance in International Trade Law* LLM thesis, Stellenbosch University (2014) 3.

[2] GC Moss “The Function of Letters of Intent and their Recognition in Modern Legal Systems” in R Schulze (ed) *New Features in Contract Law* (2007) 139 140.

[3] 140.

namely that of the "pre-contractual agreement", will be used to describe the different preliminary agreements concluded prior to the main contract.

Examples of a range of pre-contractual agreements can be found in the context of mergers and acquisitions where they are commonly used. Negotiations would usually commence with the conclusion of a declaration of purpose and this would be followed by the conclusion of further pre-contractual agreements outlining the key elements of the intended transaction in varying degrees of detail.[4] Their use is not however limited to mergers and acquisitions. As will be seen in chapter 2, pre-contractual agreements feature in many different industries and can be utilised for a wide range of purposes. This only adds to the uncertainty around their legal character and consequences.

1 2 The uncertain legal consequences of pre-contractual agreements and negotiations

The traditional rules of contract formation have for the most part been structured for contracts whose formation is immediate and no specific legal effects have been attributed to the different stages of negotiation.[5] Since pre-contractual agreements can reflect consensus on important elements of the contract, the question arises whether a contractual undertaking already exists. While in most circumstances no final contract exists because most of the clauses are yet to be created, a pre-contractual agreement could oblige parties not to renegotiate aspects already agreed upon, and it could even imply an obligation to negotiate in good faith on outstanding aspects.[6] The further question then arises what the consequences of such a preliminary contract could be - how would one establish breach and calculate damages, for example.[7]

South African research and case law on pre-contractual agreements is limited. Pre-contractual agreements of the types discussed in chapter 2 often are only treated generally, with insufficient attention being paid to their legal consequences. Therefore it may be useful to conduct comparative studies to establish whether they could aid local legal development. American law in particular has a considerable body of case law concerning pre-contractual agreements, and this in turn has given rise to

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[4] M Fontaine & F De Ly *Drafting International Contracts: An Analysis of Contract Clauses* (2006) 14.

[5] 3.

[6] 15-16.

[7] 16.

potentially valuable academic analyses.[8]

Pre-contractual agreements are controversial because they present problems that relate to the existence and extent of contractual obligations.[9] Farnsworth explains that the bulk of litigation in America regarding preliminary partial agreements raised issues regarding the intention to be bound or *animus contrahendi*, particularly in light of the fact that these agreements are often used for non-legal purposes.[10] In contrast, some agreements to negotiate, while reflecting an intention to be bound, give rise to issues regarding certainty.[11] American courts that have been called upon to decide on the enforceability of agreements to negotiate are of two minds regarding their enforceability. While some courts have been willing to give effect to the parties' express intention to bind themselves to negotiations, others refuse to recognise such agreements on grounds of uncertainty.[12] In terms of South African contract law, an agreement to negotiate with a view to concluding a main contract was until recently regarded as too uncertain to be enforceable.[13]

A specific type of pre-contractual agreement, namely an agreement to negotiate in good faith, is also investigated in greater detail. Although there has been some South African case law on this issue, the validity of an agreement to negotiate remains a grey area.[14] This type of agreement is considered in chapter 2, together with academic commentary on the topic.[15] In particular, the discussion will engage with the view that the traditional common-law approach to this type of agreement, that pre-dates the

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[8] A Hutchison "Agreements to Agree: Can There Ever be an Enforceable Duty to Negotiate in Good Faith?" (2011) 128 *SALJ* A Hutchison "Agreements to Agree: Can There Ever be an Enforceable Duty to Negotiate in Good Faith?" (2011) 128 *SALJ* 273 286.

[9] RB Lake "Letter of Intent: A Comparative Examination under English, US, French and West German Law" (1984) 18 *Geo Wash J Intl L & Econ* 331 335.

[10] EA Farnsworth "Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 *Colum LR* 217 257-258.

[11] 265.

[12] 265.

[13] G Bradfield *Christie's Law of Contract in South Africa* 7 ed (2016) 47.

[14] *Makate v Vodacom (Pty) Ltd* 2016 4 SA 121 (CC) para 100; RD McKerrow "Agreements to Negotiate: A Contemporary Analysis" (2017) 28 *Stell LR* 324.

[15] See Hutchison 2011 *SALJ* 273; McKerrow 2017 *Stell LR* 308; D Bhana & N Broeders "Agreements to Agree" (2014) 77 *THRHR* 164.

Constitution of the Republic of South Africa, 1996, requires development.[16]

Taking into account the different types of pre-contractual agreements that have become prominent in practice, this thesis will consider whether pre-contractual agreements can meet the requirements of certainty and *animus contrahendi* and thus give rise to contractual obligations. Suggestions, informed by comparative analysis, will be made regarding the types of pre-contractual agreements which should be afforded contractual status and the types of remedies that should be available for breach of such contracts.

1 3 Balancing conflicting interests in the pre-contractual phase

Most common-law systems regard freedom to terminate negotiations as a fundamental right, essential for promoting economic growth, because it provides the assurance that a party is not at risk of pre-contractual liability.[17] The rationale behind the common-law approach is that if liability is readily imposed during the pre-contractual phase it will threaten economic growth, because parties are less likely to enter into contractual negotiations for fear of legal sanction and as a result less commercial transactions will be entered into.[18]

However, liability for reliance losses in certain circumstances may be appropriate and even necessary to promote efficient transactions.[19] Economic studies have revealed that the absence of any form of pre-contractual liability can discourage parties from entering into negotiations or investing therein, for fear that their sunk costs will be wasted if the other party can break off negotiations at any stage and for any

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[16] See McKerrow 2017 *Stell LR* 308-309; Bhana & Broeders 2014 *THRHR* 176.

[17] HG Beale, B Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Text on Contract Law: Ius Commune Casebooks for the Common Law of Europe* 2 ed (2010) 381; T Irakli "The Principles of Freedom of Contract, Pre-Contractual Obligations Legal Review, EU and US Law" (2017) 13 *ESJ* 62 63,67; EA Farnsworth *Contracts* 4 ed (2004) 189; Farnsworth 1987 *Colum LR* 221; Hutchison 2011 *SALJ* 290.

[18] Beale *Cases, Materials and Text* 381; EC Melato "Precontractual Liability" in G De Geest (gen ed) *Contract Law and Economics* 2 ed (2011) 9 12*;* Farnsworth *Contracts* 189-190; B MacFarlane "The Protection of Pre-Contractual Reliance: A Way Forward" (2010) 10 *OUCLJ* 95 99; Irakli 2017 *ESJ* 67; A Schwartz & RE Scott "Precontractual Liability and Preliminary Agreements" (2007) 120 *Harv L Rev* 661 690; Farnsworth 1987 *Colum LR* 221,243.

[19] Melato "Pre-Contractual Liability" in *Contract Law* 12-16; MacFarlane 2010 *OUCLJ* 99-102; Schwartz & Scott 2007 *Harv L Rev* 667.

reason without incurring liability.[20] Early investment in negotiations (pre-contractual reliance) can improve both the efficiency of the transaction and increase its profitability for both parties.[21]

This in and of itself does not justify the intervention of the law to impose legal liability so as to protect pre-contractual reliance, but it does indicate that regulating the pre-contractual phase in a manner that promotes commerce rather than hinders it, requires the development of a very fine balance between freedom of negotiation and the imposition of liability to protect the interests of parties to negotiations.[22] This thesis will address challenging questions regarding whether obligations during the pre-contractual phase should be imposed by law or should be left to the discretion of the parties who can choose to deviate from the default position by concluding a contract. This ties in with the question of the types of agreements that are or should be contractually enforceable to address the risks discussed above, an issue which is discussed in chapter 3. It will also have to be considered whether the law of contract should be utilised to find this balance, or whether other sources of law should regulate the period prior to contract formation.

1 4 Pre-contractual liability arising from sources other than contract

If a pre-contractual agreement does not constitute a binding contract, then it is necessary to consider the possibility of non-contractual liability arising from the use of such an agreement.

This thesis will investigate the different sources of pre-contractual liability in circumstances where no binding contract has come into existence. The absence of a contract does not mean that the pre-contractual agreement has no legal effect,[23] and various sources of pre-contractual liability have to be considered.[24]

"Pre-contractual liability" has until recently been an unfamiliar concept in common-law systems and most of these systems therefore neither have a single source of pre-contractual liability, nor have they developed a special set of rules that are generally

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[20] MacFarlane 2010 *OUCLJ* 99; Melato "Pre-Contractual Liability" in *Contract Law* 12.

[21] MacFarlane 2010 *OUCLJ* 99-100.

[22] Irakli 2017 *ESJ* 67.

[23] U Draetta & RB Lake "Letters of Intent and Precontractual Liability" (1993) 7 *Intl Bus LJ* 835 836.

[24] 836.

applicable to the pre-contractual phase (such as *culpa in contrahendo* in Germany).[25] Pre-contractual liability in this context refers specifically to non-contractual liability imposed for conduct that causes loss in the course of contractual negotiations prior to contract formation.[26] The concept of pre-contractual liability refers to a stage in negotiations rather than a specific source of liability and it is classified differently in different jurisdictions.[27]

Pre-contractual expenses can take on two different forms. Firstly, a party may incur costs by performing work, rendering services or delivering goods.[28] Such performance or preparation usually takes place when negotiations give rise to an expectation that a contract will materialise.[29] Secondly, a negotiating party may expend time and resources in the course of negotiations, often referred to as "investment costs"[30] that are necessary to evaluate the other party's "commercial abilities and assess the profitability and feasibility of the transaction".[31] Such expenses are incurred in reliance that negotiations will result in the conclusion of a contract.[32] If negotiations are broken off such expenditure will be wasted.[33] While the traditional position regarding the allocation of risk and liability prior to contract formation suffices where both parties

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[25] E Pannebakker *Letter of Intent in International Contracting* LLD thesis Eramus University Rotterdam (2016) 173; N Andrews *Contract Law* 2 ed (2015) 22; J Cartwright *Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer* (2016) 74; LF Van Huyssteen & CJ Maxwell *Contract Law in South Africa* 6 ed (2019) paras 63, 191, 192, 195.

[26] N Hage-Chahine "Culpa in Contrahendo in European Private International Law: Another Look at Article 12 Of the Rome II Regulation" (2012) 32 *NWJILB* 451 452.

[27] 452.

[28] L Hawthorne & D Hutchison "Offer and Acceptance" in D Hutchison & C Pretorius (eds) *Law of Contract in South Africa* 3 ed (2017) 63; P Giliker *Pre-Contractual Liability in English and French Law* (2002) 63; J Dietrich "Classifying Precontractual Liability: A Comparative Analysis" (2001) 21 *Legal Stud* 153; P Giliker "A Role for Tort in Pre-Contractual Negotiations? An Examination of English, French and Canadian Law" (2003) 52 *ICLQ* 969 970.

[29] Hawthorne & Hutchison "Offer and Acceptance" in *Law of Contract* 63; LF Van Huyssteen, GF Lubbe & MFB Reinecke *Contract: General Principles* 5 ed (2016) 85.

[30] Schwartz & Scott 2007 *Harv L Rev* 663-664,676-677.

[31] JM Creed "Integrating Preliminary Agreements into the Interference Torts" (2010) 110 *Colum LR* 1253 1270; see Schwartz & Scott 2007 *Harv L Rev* 676-677.

[32] Van Huyssteen et al *Contract* 85; AT Von Mehren "The Formation of Contracts" in *International Encyclopedia of Comparative Law VII - Contracts in General* (2008) para 112.

[33] Van Huyssteen et al *Contract* 85.

have conducted themselves properly, it may be inadequate where negotiations break down due to the blameworthy conduct of one of the parties.[34]

The analysis of liability arising from non-contractual sources during the pre-contractual phase is important for purposes of ultimately drawing an informed conclusion about whether the classical rules of contract formation require further development to extend contractual force to certain pre-contractual agreements (concluded prior to the principal contract), or whether liability appropriately falls to be dealt with by other sources of law. In the English case of *Cobbes v Yeoman Row Management Ltd*[35] *("Cobbes*") for example, the court reasoned that there were "plenty of other ways of dealing with particular problems of unacceptable conduct occurring in the course of negotiations without unduly hampering the ability of the parties to negotiate their own bargains without the intervention of the court".[36] Imposing liability in the law of contract does not exclude the possibility of also imposing liability based on other sources of law and it may therefore be appropriate for pre-contractual obligations to arise from more than one source of law.

Civil law systems and common-law systems differ vastly in their approach to regulating the pre-contractual phase, particularly insofar as it concerns freedom to break off negotiations and the imposition of a duty of good faith; this impacts whether there will be liability and if so the basis for such liability.[37] The sources of pre-contractual liability that will be considered in this thesis are the law of delict, and the law of unjustified enrichment.

As yet, no general theory of pre-contractual liability has developed in South African law, but liability for certain forms of conduct during the pre-contractual phase could potentially be imposed by relying on the general principles of the law of delict.[38] The law of delict as a source of liability is relevant in the context of pre-contractual reliance. Certain representations can be made in pre-contractual agreements which gives rise to a reliance by the other party that the main contract will be concluded. Parties can incur expenses pursuant to such representations.

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[34] 85.

[35] [2006] EWCA Civ 1139 para 4.

[36] Para 4.

[37] Moss "The Function of Letters of Intent" in *New Features in Contract law* 148.

[38] Van Huyssteen & Maxwell *Contract Law* paras 191-193.

In South Africa delictual liability is imposed for fraudulent misrepresentations in the pre-contractual phase, even where no contract materialises.[39] The imposition of delictual liability for negligent misrepresentations, made in circumstances where no contract comes into existence, is more problematic.[40] To provide a delictual action in these circumstances would require the extension of liability for negligent misrepresentations to recognise that representations made in the pre-contractual phase are also actionable where it forms the basis of a reliance and the envisaged contract fails to materialise.[41]

A party that has suffered loss due to failed contractual negotiations will generally be claiming compensation for pure economic loss. Courts are hesitant to impose delictual liability for pure economic loss for fear of opening the floodgates to large numbers of claims. This may pose a challenge to pre-contractual liability founded in delict. The law of delict as a source of liability will be considered in further detail,[42] this will include an analysis of the case of *Murray v McLean*[43] in which the court refused to impose liability for pre-contractual losses suffered when no contract came into existence.

It is also possible for the law of unjustified enrichment to be relevant in the pre-contractual phase - a party to negotiations may take preparatory steps or carry out certain work in anticipation of concluding the envisaged contract, which benefits the other party.[44] Restitution of benefits received during contract negotiations is one of the fundamental grounds for pre-contractual liability.[45] A claim for unjustified enrichment only exists if it can be shown that a party was unjustifiably enriched in the sense that he received a benefit from the other party without a legal cause. The possibility and utility of developing these areas of law so as to provide for pre-contractual liability will be considered with reference to the different approaches adopted in South African, American, English and German law. The remedies that can be claimed under each source of liability will also be set out.

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[39] A Hutchison "Liability for Breaking off Contractual Negotiations" (2012) 129 *SALJ* 104 124.

[40] 124.

[41] 125.

[42] See ch 5 (5 2).

[43] 1970 1 SA 133 (R).

[44] R Havelock "Anticipated Contracts That Do Not Materialise" (2011) 19 *RLR* 72 72.

[45] Farnsworth 1987 *Colum LR* 229.

Hutchison suggests that South African law on pre-contractual liability requires development, particularly due to the fact that a comparative perspective reveals that foreign jurisdictions have dealt with pre-contractual liability differently.[46] This thesis will address whether the rules regarding non-contractual liability in the context of pre-contractual agreements should be developed. American courts for example have looked to flexible concepts, such as promissory estoppel and good faith, to provide recourse to parties who have relied upon non-binding pre-contractual agreements.[47]

It should be noted that for purposes of this thesis, the focus will be limited to the legal consequences where parties voluntarily choose to impose upon themselves an obligation to negotiate in good faith. The general role of the Constitutional value of good faith in the pre-contractual phase and the potential pre-contractual duties that may arise therefrom, even if no such obligation is imposed voluntarily, are consequently beyond the scope of this thesis.

1 5 Relevance of this study

The seminal American case of *Texaco Inc v Pennzoil Co*[48] (*Texaco*) illustrates the commercial and legal significance of the legal uncertainty in relation to pre-contractual agreements, as well as the importance of clarifying their legal consequences. In this case the parties had entered into an agreement in principle for the sale of shares in a company. Although parties had reached agreement on the essential terms of the envisaged transaction, the parties contemplated further negotiations and the conclusion of a definitive agreement recording all the terms of the transaction. The jury reached the conclusion that the parties were bound by the contract and consequently awarded ten billion dollars in damages for tortious interference with a contract.[49]

The *Texaco* case highlights the inherent risk of the uncertainty around the legal consequences of pre-contractual agreements and the application of the traditional "all-or-nothing"-approach to contract formation. Courts are forced in these circumstances to either conclude that a fully-binding contract had been concluded or that no legal

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[46] 2012 *SALJ* 105.

[47] LA DiMatteo, LJ Dhooge, S Greene, VG Maurer & MA Pagnattaro *International Sales Law: A Critical Analysis of CISG Jurisprudence* (2005) 32.

[48] (1987) 729 S W 2d (Tex App) 768.

[49] 866.

consequences flow from the preliminary agreements concluded in the course of negotiations. This places courts in an extremely difficult position, particularly in circumstances where the aggrieved party should be entitled to some form of remedy which amounts to something less than enforcement of the principal agreement.

It has already been highlighted that the classical rules of contract formation, which envisage that parties will reach agreement almost instantaneously, may not necessarily cater for the complexities of modern commerce that entail prolonged negotiations, the involvement of teams of experts and substantial investment of time and resources.[50] As part of the analysis into the legal consequences of pre-contractual agreements, it will be considered whether the traditional principles of contract formation are out of step with modern commercial needs. In this regard it is vital to keep the following sentiment in mind:

> "In some moments of history doctrine lags behind social realities and discovers legal rules to be disconnected from their initial justifications. The result is a direct confrontation between the desire for predictable legal rules to fulfil the promise of the rule of law and the consistent nature of social progress. As a way of resolving this confrontation, legal rules must be innovative too…"[51]

As previously mentioned, South African contract law attaches great importance to freedom of contract and tends, in the absence of a binding contract, to support an adversarial approach to contractual negotiations.[52] Traditionally the law of contract merely regulates the parties in the adversarial pursuit of concluding a transaction. However, the role of contract law in the regulation of contractual relationships has seen a shift since the advent of the Constitution. This has laid the foundation for the doctrine of good faith to be developed to promote societal values and fairness in contractual negotiations.[53] This shift is highlighted by the judgement of the Constitutional Court in *Everfresh Market Virginia v Shoprite Checkers (Pty) Ltd,*[54]

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[50] Giliker *Pre-Contractual Liability* 31; Irakli 2017 *ESJ* 62 66.

[51] Creed 2010 *Colum LR* 1254.

[52] Hutchison 2011 *SALJ* 275.

[53] AM Louw "Yet Another Call For a Greater Role for Good Faith in the South African law of Contract: Can we Banish the Law of the Jungle,while Avoiding the Elephant in the Room?" (2013) 16 *PELJ* 44 46-50; A Hutchison "Good Faith in Contract: A Uniquely South African Perspective" (2019) 1 *Journal of Commonwealth Law* 227 230-233, 260; Van Der Sjide *The Role of Good Faith* 30, 36.

[54] 2012 1 SA 256 (CC) para 72.

which recognised that the values of good faith and *ubuntu* could justify the recognition and enforcement of agreements to negotiate in good faith in the future.[55] While the court did not actually go on to develop the common-law position on agreements to negotiate, it planted the seed for potential change and developments to the law of contract which merits further investigation.

1 6 Overview of chapters and methodology

In this thesis we shall consider the different types of pre-contractual agreements and the legal consequences (if any) flowing from these types of agreements in terms of the South African law of contract. Due to the limited South African case law and literature on pre-contractual agreements, it will be essential to conduct a comparative study of the treatment of these types of agreements in foreign jurisdictions. To this end, we will critically consider and analyse the legal treatment of pre-contractual agreements in the American, English and German legal systems in order to be better placed to evaluate the present approach to pre-contractual agreements in South Africa and to determine the scope for potential development.

This thesis will proceed as follows. As a point of departure, in chapter 2 the various types of pre-contractual agreements will be set out and classified according to their nature and function. In chapter 3 we shall consider which types of pre-contractual agreements (if any) can meet the validity requirements for a contract in the different legal systems under consideration. This analysis shall be conducted based on the classification of the different types of pre-contractual agreements in chapter 2. In chapter 4, the legal consequences arising from pre-contractual agreements will be set out based on the conclusions reached in chapter 3. In light of the fact that pre-contractual agreements are diverse instruments that do not have a standardised legal content, it will be necessary in the course of this study to investigate the potential legal consequences of pre-contractual agreements that may arise from non-contractual sources of law. Therefore in chapter 5 we will examine pre-contractual liability arising from non-contractual sources of law. More specifically we will consider whether the conclusion of a pre-contractual agreement can form the basis for the imposition of

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[55] McKerrow 2017 *Stell LR* 328; E van der Sijde *The Role of Good Faith in the South African Law of Contract* LLM thesis Pretoria University (2012) 30.

liability in the law of delict and the law of unjustified enrichment in the respective legal systems under consideration. Lastly chapter 6 shall set out some concluding observations regarding the status of pre-contractual agreements in South African law and whether the present approach to these agreements requires development, particularly in light of the *Everfresh* case and more broadly the approach adopted in other legal systems, such as German and American law.

Chapter 2: Types of pre-contractual agreements and their function

2 1 Introduction

Before considering the different types of pre-contractual agreements and their function, some preliminary observations must be made. Pre-contractual agreements are a diverse range of instruments utilised to simplify the negotiation process and to facilitate the conclusion of the main contract, and the type of agreement used to achieve these objectives is dependent upon the specific requirements of the parties involved.[1] The term "pre-contractual" can be misleading. These agreements are pre-contractual in the sense that they are concluded prior to an anticipated main contract. This terminology does not exclude the possibility that these types of agreements can give rise to contractual obligations related to the subject matter of the future contract under negotiation or to the negotiation process itself.[2]

The categorisation of pre-contractual agreements into distinct legal categories is a challenging task. Pre-contractual agreements do not have standardised legal content. While some terms are common to most of these agreements, the wording and content of any particular agreement is ultimately left to the discretion of the specific drafters.[3] In order to consider the legal consequences of these types of agreements, it may be beneficial to attempt to organise the large body of diversified agreements constituting pre-contractual agreements into different categories. The various types of agreements will be categorised into two broad categories, utilising neutral names that best describe their nature and function. However, it is accepted that this method of classification is imperfect and that a single agreement can display elements of more than one type of pre-contractual agreement or seek to perform more than one function.

Torsello has categorised pre-contractual agreements into three fundamental

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[1] J Schmidt "Preliminary Agreements in International Contract Negotiation" (1983) 6 *Hous J Int'l L* 37 48-52.

[2] U Draetta "Precontractual Documents in Merger or Acquisition Negotiations: An Overview of the International Practice" (1991) 2 *Int'l Bus LJ* 229 229-230.

[3] J Cardenas "Deal Jumping in Cross-Border Merger & Acquisition Negotiations: A Comparative Analysis of Pre-Contractual Liability under French, German, United Kingdom and United States Law" (2013) 9 *NYU J L & Bus* 941 948-949.

categories: agreements that oblige the parties to negotiate, agreements imposing limited obligations regarding the negotiations, and agreements imposing an obligation to conclude the final contract.[4] From this categorisation it is possible to deduce that pre-contractual agreements can ultimately be classified into agreements which relate to the contractual negotiation process and those which relate to the substance and conclusion of the envisaged main contract.[5]

Clarifying the function that pre-contractual agreements are intended to fulfil may assist in overcoming litigious difficulties and issues that will arise when a court is tasked with ascertaining the parties' intentions with regard to a pre-contractual agreement.[6] With this in mind, the types of pre-contractual agreements and their potential functions will be considered by way of practical examples.

2 2 Agreements to negotiate and agreements structuring negotiations

Pre-contractual agreements can contain specific binding provisions relating to the rights and obligations of the parties in the period between entering into the pre-contractual agreement and conclusion of the final contract.[7] These types of agreements generally set out the ground rules regarding the process or manner in which negotiations should be conducted.[8] They can include obligations relating to the performance of preliminary investigations, disclosure and non-disclosure, and dispute resolution.[9]

Negotiating parties at times seek to impose specific obligations in the course of their negotiations to protect them against certain pre-contractual risks.[10] There are

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[4] M Torsello "Preliminary Agreements and CISG Contracts" in HM Flechtner, MS Walter & RA Brand (eds) *Drafting Contracts under the CISG* (2008) 191 214.

[5] Schmidt 1983 *Hous J Int'l L* 38.

[6] GG Gosfield "The Structure and Use of Letters of Intent in Pre-Negotiation Contracts for Prospective Real Estate Transactions" (2003) 38 *Real Prop Prob & Tr J* 100 105.

[7] NB Jeffries "Preliminary Negotiations or Binding Obligations? A Framework for Determining the Intent of the Parties" (2012) 48 *Gonz L Rev* 1 8-9.

[8] Gosfield 2003 *Real Prop Prob & Tr J* 100.

[9] B Tremml "The Acquisition of Closely Held Companies" in M Wendler, B Tremml & B Buecker (eds) *Key Aspects of German Business Law: A Practical Manual* 4 ed (2008) 39 43.

[10] EM Weitzenboeck *A Legal Framework for Emerging Business Models: Dynamic Networks as Collaborative Contracts* (2012) 95.

significant commercial repercussions that may ensue if contractual negotiations fail and a final contract does not arise; parties conclude pre-contractual agreements to regulate negotiations and to limit the commercial risk associated with such negotiations.[11] The conclusion of this type of agreement to negotiate is therefore at times a prerequisite for the commencement or continuation of negotiations.[12] The various obligations relating to or necessary for negotiations shall be individually discussed.[13] This will be followed by an exposition of their practical function.[14]

It should be noted that while for purposes of convenience these obligations are often included in pre-contractual agreements containing terms that are predominantly non-binding, the parties usually intend obligations regarding the negotiations to be contractually binding.[15]

2 2 1 Confidentiality and non-disclosure

Confidential information often has a great economic value, particularly for the person holding it.[16] There are various circumstances that require the disclosure of valuable, private information and it is necessary for the holder of such information to take certain precautions to ensure that the use of such information is strictly limited to the purpose for which it was disclosed; in this way the value of the confidential information is maintained.[17] Confidential information has various sources of protection. In most civil law systems, there are pre-contractual duties that may arise ex lege in the course of negotiations, and this can include the duty to keep certain information confidential.[18] The duty not to disclose confidential information is also provided for in the UNIDROIT Principles of International Commercial Contracts (PICC)[19] and the Principles of

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[11] 96.

[12] RB Lake & U Draetta *Letters of Intent and Other Precontractual Documents: Comparative Analysis and Forms* (1989) 120.

[13] See ch 2 (2 2 1 - 2 2 6).

[14] See ch 2 (2 3 3 5).

[15] Schmidt 1983 *Hous J Int'l L* 49.

[16] M Fontaine & F De Ly *Drafting International Contracts: An Analysis of Contract Clauses* (2009) 231

[17] 231.

[18] PB Quagliato "The Duty to Negotiate in Good Faith" (2008) 50 *IJLMA* 213 216; see also Draetta 1991 *Int'l Bus LJ* 232, where it is stated that duties of confidentiality may arise from the general obligation to negotiate in good faith, which is imposed upon commencement of negotiations in most civilian systems.

[19] See art 2.1.16.

European Contract Law (PECL).[20] By contrast, common-law systems do not recognise a general obligation to negotiate in good faith from which duties of confidentiality could potentially be derived, but the law may provide some protection for certain confidential information.[21] It is however generally accepted that the national rules of a specific legal system will in many circumstances not provide adequate protection for confidential information. Parties who wish for certain information exchanged in the course of negotiations to be kept confidential will need to safeguard themselves by concluding a confidentiality agreement, also commonly referred to as a non-disclosure agreement.[22]

Confidentiality or non-disclosure obligations can form part of an otherwise non-binding pre-contractual agreement or they could be contained in a binding stand-alone agreement. A confidentiality agreement will generally contain a definition of confidential information which describes the scope of information covered by the agreement. [23] This will generally be accompanied by a provision limiting the disclosure and use of such information.[24] Confidentiality agreements therefore can be said to fulfil two main functions. First, they could expressly prohibit the disclosure of confidential information exchanged during negotiations to third parties and secondly, they could expressly prohibit the use of such information for any purpose other than that for which it was disclosed.[25] The functions of confidentiality agreements will now be considered with reference to their practical application in merger and acquisition negotiations.

Confidentiality agreements perform a particularly important function in merger and acquisition negotiations, where the buyer may require disclosure of private information regarding the finances and trade secrets of the target company in order to evaluate

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[20] See art 2:302.

[21] Fontaine & De Ly *Drafting International Contracts* 231 286; VS Foreman "Non-Binding Preliminary Agreements: The Duty to Negotiate in Good faith and the Award of Expectation Damages" (2014) 72 *U Toronto Fac L Rev* 15 23.

[22] Fontaine & De Ly *Drafting International Contracts* 231.

[23] F Adoranti *The Managers Guide to Understanding Confidentiality Agreements* (2006) 5-6; see appendix A , in this thesis, for an example of this type of agreement.

[24] RB Thompson *Mergers and Acquisitions: Law and Finance* (2018) 93; Adoranti *Understanding Confidentiality* Agreements 6.

[25] CS Harrison *Make the Deal: Negotiating Mergers and Acquisitions* (2016) 10-11.

the benefit of the envisaged transaction.[26] There is however an inherent risk that a buyer will commence negotiations for the sole purpose of gaining access to confidential information of the target company. The disclosure of confidential information is often viewed by the seller as a "necessary evil" to ensure that the transaction is successful.[27] The parties will generally conclude a confidentiality agreement before proceeding to the stage of negotiations that requires the disclosure of confidential information.[28] Provisions in a confidentiality agreement restricting the disclosure and use of confidential information can be utilised to provide some protection to the seller and limit the potential damage that could be suffered if the buyer discloses confidential information to a competitor.[29] It is also common for confidentiality agreements in this context to have a clause prohibiting a party from using the confidential information to compete with the target company.[30]

Confidentiality agreements can also indirectly prohibit certain actions during merger and acquisition negotiations.[31] For example, a signed confidentiality agreement could protect the seller of the target company against the buyer trying to employ key personnel of the target company.[32] In the course of merger and acquisition negotiations, the buyer will be introduced to, and become familiar with the key personnel of the target company.[33] This allows the buyer to identify the most valuable employees. If negotiations fail and the intended transaction is not concluded, there is an inherent risk that the buyer will seek to achieve a similar result to the intended transaction by simply employing the key personnel of the target company and creating its own competing entity.[34] This action would generally be indirectly connected to the exchange of confidential information, insofar as the buyer is informed of and introduced to the key employees of the target company. Depending on the definition

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[26] 8.

[27] 11.

[28] M Baum "Mergers and Acquisitions" in J Basedow, KJ Hopt & R Zimmermann (eds) *The Max Planck Encyclopedia of European Private Law II* (2012) 1171 1173.

[29] Harrison *Make the Deal* 11.

[30] 11.

[31] Draetta 1991 *Int'l Bus LJ* 246.

[32] 246.

[33] Harrison *Make the Deal* 33.

[34] Draetta 1991 *Int'l Bus LJ* 246.

of confidential information and prohibition of use clauses in the confidentiality agreement, the agreement could arguably be interpreted to prohibit the use of such information if it would be to the detriment of the seller.[35] It is however more common for an express clause prohibiting the solicitation or hiring of key personnel of the target company to be included in a confidentiality agreement to ensure that the seller is expressly protected against the risk of having employees poached.[36]

Confidentiality agreements used in the context of mergers and acquisitions involving a public company will generally contain a standstill provision which functions to prevent hostile takeovers by the potential buyer.[37] A standstill provision expressly prohibits specific conduct on the part of the buyer that involves acquiring control over the target company in a manner that bypasses the involvement of its board of directors.[38] Such a provision prohibits a buyer from making an offer to shareholders to acquire any equity with voting rights attached to it in the target company.[39] Proxy contests initiated by the buyer to replace some or all of the board of directors of the target company are also prohibited.[40]

Whether non-disclosure obligations that perform the above-mentioned functions can be implied by an agreement imposing a general obligation to negotiate in good faith is both uncertain and controversial. De Ly and Fontaine suggest that a duty of confidentiality, even in the absence of an express confidentiality clause, could potentially arise from an obligation to negotiate in good faith.[41] To avoid the complications that could arise from uncertainty surrounding the duties that arise from an overarching obligation to negotiate in good faith, it is advisable that parties who require confidentiality in their negotiations include an express clause in their agreement to that effect.

2 2 2 Exclusivity

It is generally accepted that parties should be free to conduct parallel negotiations with

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[35] 246.

[36] Harrison *Make the Deal* 34.

[37] 35.

[38] Thompson *Mergers and Acquisitions* 93.

[39] 93.

[40] 93.

[41] Fontaine & De Ly *Drafting International Contracts* 46.

more than one party; to hold otherwise would considerably hinder the efficiency of business transactions.[42] However, this freedom does pose a significant practical problem: a negotiating party would not want to sink costs into negotiations that are unlikely to result in the conclusion of a final contract. If the other party is negotiating with third parties, there is great uncertainty as to whether that party is serious about negotiations or whether she is merely misusing the negotiation process as a bargaining tool in the negotiations with a third party.

Negotiating parties therefore often conclude exclusivity agreements.[43] An exclusivity provision can form part of a confidentiality agreement, but in practice it is more common for exclusivity provisions to be contained in a stand-alone agreement concluded after initial negotiations regarding the intended transaction and subsequent to the confidentiality agreement.[44]

An exclusivity agreement prohibits one or both of the negotiating parties from participating in parallel negotiations during the prescribed period of exclusivity.[45] It thus prohibits a negotiating party from soliciting other offers, providing confidential information to a third party, or concluding the transaction with a third party.[46] An exclusivity agreement can oblige the parties to negotiate with a view to reaching consensus, but it does not require that they reach agreement regarding the terms of the envisaged transaction or conclude the main contract.[47]

In the context of merger and acquisition negotiations, an exclusivity agreement will generally be concluded when negotiations have reached the stage where more comprehensive due diligence is required.[48] Exclusivity agreements provide the potential buyer with the time to evaluate and finalise the intended transaction without having to bear the risk that the seller will enter into negotiations with a third party or

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[42] EA Farnsworth "Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 *Colum LR* 217 279; Fontaine & De Ly *Drafting International Contracts* 25.

[43] See appendix B, in this thesis, for an example of such a contract.

[44] Harrison *Make the Deal* 42.

[45] YU Yamazaki "Preliminary Agreements as Contracts: Facilitating Socially Desirable Transactions using Doctrines of Injunctions, Disgorgement and Tortious Interference" (2012) 9 *NYU J L & Bus* 373 424.

[46] Harrison *Make the Deal* 42.

[47] 47.

[48] Yamazaki 2012 *NYU J L & Bus* 424.

conclude the transaction with a third party during that period.[49]

In the absence of an exclusivity provision, a buyer may be very reluctant to risk the substantial investment costs involved in due diligence investigations.[50] This provision does not guarantee that the intended transaction will be concluded, but it does give the buyer the assurance that the seller regards him as the preferred party with whom to conclude the transaction.[51]

Exclusivity agreements can also impose an obligation to negotiate in good faith during the prescribed exclusivity period.[52] This will only be included in an exclusivity agreement if the parties have already reached consensus on key terms of the business transaction.[53] The reason for this, lies in the fact that once consensus has been reached on the key terms, there is a far greater likelihood that the contract will be concluded and that parties will rely on the materialisation such contract, as such the parties are more inclined to include an obligation obliging parties to negotiate in good faith to provide themselves with some protection. An obligation to negotiate in good faith, as discussed below, can function to prevent parties from re-negotiating terms already agreed upon and would thus perform a useful function once key terms have been agreed.[54] A provision in an exclusivity agreement imposing an obligation to negotiate in good faith may be intended to give rise to a legal obligation or a moral obligation.[55]

Alternatively, parties may conclude a pre-contractual agreement that only imposes an obligation to negotiate in good faith. Whether such a clause could imply a duty of exclusivity and prohibit the sudden breaking-off of negotiations pursuant to parallel negotiations is uncertain.[56] In terms of American law this conduct could constitute breach of an obligation to negotiate in good faith, if imposed by a valid contract to

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[49] Harrison *Make the Deal* 41.

[50] 41.

[51] 42.

[52] 46.

[53] 46.

[54] See ch 2 (2 2 6).

[55] 46.

[56] U Draetta & RB Lake “Letters of Intent and Pre-Contractual Liability” 1993 *Int’l Bus LJ* 835 855; Farnsworth 1987*Colum LR* 279.

negotiate.[57] Whether an obligation to negotiate in good faith implies an exclusivity undertaking ultimately depends upon the facts of the case.[58]

2 2 3 Framework for the process of negotiation

In complex transactions, the negotiation process often requires a substantial amount of planning to ensure efficiency and to avoid complications.[59] Pre-contractual agreements are often used to provide a framework for the negotiation process.[60] Such a framework normally identifies the individuals who will be responsible for the different components of the negotiations, and sets out the agreements required to regulate the various components of the envisaged transaction.[61] Such agreements can also establish a time framework for negotiations. In terms of a time framework agreement parties are obliged to make a good faith effort to comply with the time schedule set for the negotiation process.[62]

2 2 4 Allocation of risk of loss or wasted expenditure

Parties often engage in a variety of activities to bring them closer to concluding the final contract. These activities, which include conducting feasibility studies, market research and location analysis, could require incurring considerable expenditure.[63] While the general rule is that each negotiating party carries the risk of loss or wasted expenditure pursuant to failed negotiations, parties may choose to allocate risk differently.[64] Agreements to negotiate can therefore serve to allocate responsibility for pre-contractual expenditure between the parties.[65]

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[57] *Channel Home Centers, Div of Grace Retail Corp v Grossman* (1986) 795 F 2d 291 (3rd Cir) 299-300; Draetta & Lake1993 *Int'l Bus LJ* 855.

[58] Fontaine & De Ly *Drafting International Contracts* 25.

[59] Lake & Draetta *Letters of Intent* 14.

[60] Lake & Draetta *Letters of Intent* 14; see appendix C, in this thesis, for an example of this type pre-contractual agreement.

[61] 14.

[62] Draetta & Lake 1993 *Int'l Bus LJ* 855-856. It will be observed in ch 5 (5.3) that parties often start performing even though this framework has not been adhered to, and that this can give rise to liability in the law of unjustified enrichment where parties have rendered performance in purported fulfilment of a contract which is never finally concluded.

[63] Tremml "The Acquisition of Companies" in *German Business Law* 43.

[64] Gosfield 2003 *Real Prop Prob & Tr J* 162.

[65] 161.

A negotiating party who conducts preliminary investigations that are beneficial to the other party could require a clause to be included in an agreement to the effect that she will be reimbursed for expenditure incurred if negotiations are terminated without cause.[66] In terms of American law there are some instances where a clause allocating expenses or shifting the risk of costs can serve as an indication that the pre-contractual agreement or at least a part thereof is intended to be contractually binding.[67] In this jurisdiction, even if the allocation of risk clause is contained in an otherwise non-binding agreement, it may still be binding with respect to reimbursement for pre-contractual expenditure.[68]

2 2 5 Limitation of liability and liquidated damages clauses

Agreements to negotiate which impose limited contractual obligations can also contain a provision limiting the extent of liability arising from both the law of contract and from other sources of law such as the law of delict.[69] A clause may for example limit the scope of liability for direct or consequential losses arising from the breach of contractual obligations, such as duties to maintain confidentiality.[70]

Alternatively, parties can choose to set out the exact extent of liability for breach of a contractual obligation by including a liquidated damages clause which provides that an agreed upon sum of damages will be payable for breach.[71] It is particularly common for parties to include a liquidated damages clause in exclusivity and confidentiality agreements, due to the difficulties involved in establishing the extent of loss that has been suffered as a result of breach.[72] A liquidated damages clause removes the

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[66] 160-161.

[67] Gosfield 2003 *Real Prop Prob & Tr J* 162; see also *Opdyke Investment Company v Norris Grain Company* 320 N W 2d 836 (Mich 1982) 362 where the court concluded that the deletion of a clause stating that each party was liable for their own costs from an earlier letter of intent in the subsequent letter of intent constituted a factor from which the inference could be drawn that the parties intended the second letter of intent to give rise to contractual liability for costs incurred by the other party.

[68] See *VS & A Communication Partners, L.P v Palmer Broadcasting Limited Partnership* (1992) WL 339 377 (Del Ch) 10 where the court confirmed that it is possible for parties to enter into a binding agreement allocating the risk for pre-contractual expenditure prior to conclusion of the envisaged transaction.

[69] Gosfield 2003 *Real Prop Prob & Tr J* 157; LE Espenschied *Contract Drafting: Powerful Prose in Transactional Practice* (2010) 46-47.

[70] Fontaine & De Ly *Drafting International Contracts* 355.

[71] Espenschied *Contract Drafting* 49; Draetta 1991 *Int'l Bus LJ* 245

[72] MA Denicolo *Acquisitions 2017* (2017) paras 2 5 1, 2 5 2 2.

evidentiary burden of proving the quantum of damages in the event of breach of duties of confidentiality or exclusivity.[73] The enforceability of such a clause does give rise to difficulties in some common-law systems - it is possible that courts, in jurisdictions such as America, will refuse to enforce this provision because it is regarded as a penalty clause.[74] English law has seen some development in this regard and will enforce penalty clauses provided they serve a legitimate interest.[75] In terms of German law[76] and South African law this is not an issue as penalty clauses in contracts are enforceable as a general rule.[77]

2 2 6 Good faith

Negotiation clauses in commercial pre-contractual agreements are an ever-increasing phenomenon, particularly in cases where the final contract is the product of lengthy negotiation.[78] An agreement to negotiate seeks to place an obligation on the parties to commence or continue negotiations until agreement is reached on all outstanding aspects and a final contract can be concluded.[79] Negotiation clauses may be contained in a pre-existing contract, in a pre-contractual agreement outlining the terms of the envisaged transaction or in an agreement comprised solely of the obligation to negotiate.[80]

Agreements to negotiate will inevitably raise questions regarding the application and role of the obligation to negotiate in good faith, either because there is an express reference to such obligation in the negotiation clause, or because it arises by implication. At this point it is necessary to draw a distinction between good faith as an underlying value in the South African law of contract, which is given effect to by specific

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[73] LA Tompkins "Confidentiality Agreements in a Commercial Setting: are they Necessary?" (2008) 27 *ARELJ* 198 211; Denicolo *Acquisitions* para 2 5 2 2.

[74] Draetta 1991 Int'l Bus LJ 245.

[75] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis* [2015] UKSC 67.

[76] G Dannemann "Common Law-based Contracts under German Law" in GC Moss (ed) *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (2011) 71.

[77] LF Van Huyssteen, GF Lubbe & MFB Reinecke *Contract: General Principles* 5 ed (2016) 423-424.

[78] Farnsworth 1987 *Colum LR* 219; J O'Connor "The Enforceability of Agreements to Negotiate in Good Faith" (2010) 29 *Tas L Rev* 177 184.

[79] Gosfield 2003 *Real Prop Prob & Tr J* 108.

[80] LE Trakman and K Sharma "The Binding Force of Agreements to Negotiate in Good Faith" (2014) 73 *CLJ* 598 617-619.

rules or duties[81] and the specific obligation to negotiate a contract in good faith.[82] For purposes of this thesis the enquiry will be limited to the obligation of good faith that could potentially be imposed by an agreement to negotiate.

Before considering the obligation to negotiate in good faith as derived from an agreement to negotiate, it may be beneficial briefly to refer to the legal position of different jurisdictions and to the supra-national rules regarding the obligation to negotiate in good faith, because it can impact on the recognition and legal effect of such an obligation.[83] In civil law systems such as Germany and France in particular, the obligation to act in good faith is well developed[84] and parties are expected to negotiate in good faith irrespective of the existence of an agreement to that effect.[85] In fact, agreements to negotiate to this effect are said to only strengthen the existing obligation to negotiate in good faith.[86] The supra-national rules of contract law also seem to support the imposition of an obligation to negotiate in good faith.[87]

In most common-law systems, however, there is no general rule which requires parties to negotiate in good faith, but specific legislation may require displaying some degree of good faith in the pre-contractual phase.[88] The general obligation to negotiate in good faith has yet to enjoy recognition in England,[89] although there has been case law suggesting that an agreement containing an express obligation to negotiate in

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[81] *Barkhuizen v Napier* 2007 5 SA 323 (CC) para 82; G Lubbe "Bone fides, Bilikheid en Openbare Belang in die Suid-Afrikaanse Kontraktereg" (1990) 7 *Stell LR* 7 19-22; Zimmermann "Good Faith and Equity" in R Zimmermann & DP Visser (eds) *Southern Cross: Civil Law and Common Law in South Africa* (1996) 217 218, 281; A Hutchison "Good Faith in Contract: A Uniquely South African Perspective" (2019) 1 *Journal of Commonwealth Law* 227 260-263.

[82] C Perry "Good Faith in English and US Contract Law: Divergent Theories, Practical Similarities" (2016) 17 *BLI* 27 28.

[83] Trakman & Sharma 2014 *CLJ* 609-610.

[84] B Zellar "Good Faith - Is it a Contractual Obligation?" (2003) 15 *BLR* 215; see also Trakman & Sharma 2014 *CLJ* 606 where it is explained that this obligation arises from an integrated framework of the law of delicts and the law of contract.

[85] Quagliato 2008 *IJLMA* 221.

[86] Draetta & Lake 1993 *Intl' Bus LJ* 839; 848,850,854-855; GC Moss "The Function of Letters of Intent and their Recognition in Modern Legal Systems" in R Schulze (ed) *New Features in Contract Law* (2007) 139 152.

[87] See art 2.1.15 (2) of the PICC read with comment 2; see also art 2:301 of the PECL.

[88] Quagliato 2008 *IJLMA* 217.

[89] Perry 2016 *BLI* 27, 34.

good faith may be enforceable.[90] In America such an obligation has received some recognition, and courts have also indicated a willingness to enforce express duties to negotiate in good faith.[91] In terms of American and English law there seems to be an implicit distinction between agreements to negotiate that seek to impose an express obligation to negotiate in good faith, and those which do not.[92] It appears that in both jurisdictions courts will generally refuse to imply an obligation of good faith into an agreement to negotiate where no express obligation has been included.[93]

In South African law, agreements to negotiate have traditionally been regarded as unenforceable due to the unfettered discretion vesting in parties to agree or disagree.[94] More recent South African case law suggests that there are certain types of agreements to negotiate which may be valid and enforceable.[95] There are various factors that affect the validity and enforceability of agreements to negotiate,[96] but for present purposes the focus will be on the role of the obligation to negotiate in good faith and its application to agreements to negotiate.

Two questions are pertinent in this context. First, is it essential for the validity of an agreement to negotiate that the proposed negotiations have to be conducted in good faith? Secondly, if the proposed negotiations have to be conducted in good faith, does the duty to do so arise automatically, or are parties required to agree on it? These questions go to the validity of agreements to negotiate in good faith and will be dealt with in chapter 3.[97] For present purposes it is sufficient to note that there is conflicting South African case law on these issues.[98] In *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd*,[99] for example, the court concluded that

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[90] See *Petromec Inc v Petroleo Brasileiro SA Petrobas* [2005] EWCA Civ 891.

[91] Perry 2016 *BLI* 29; See *Siga Technologies Inc v PharmAthene Inc* 2013 67 A 3d 330 (Del) 333.

[92] Perry 2016 *BLI* 28.

[93] Perry 2016 *BLI* 36; see also the English case of *Walford v Miles* [1992] 2 AC 128.

[94] *Premier, Free State v Firechem Free State (Pty) Ltd* 2000 4 SA 413 (SCA) para 35; Van Huyssteen et al *Contract* 220. See ch 3 regarding the validity of agreements to negotiate.

[95] See *Southernport Developments (Pty) Ltd v Transnet Ltd* 2005 2 SA 202 (SCA); *Makate v Vodacom Ltd* 2016 4 SA 121 (CC); *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC).

[96] See ch 3.

[97] See ch 3 (3 2 2 1).

[98] See ch 3 (3 2 2 1).

[99] 2012 6 SA 96 (WCC) paras 19-22.

duties to negotiate obliged parties to negotiate in good faith and that the absence of a reference to good faith in an agreement to negotiate was not a material issue because courts could readily imply such a standard into a contract in the appropriate circumstances. On the other hand, in *Roazar v Falls Supermarket CC* ("*Roazar*")[100] the court pinpointed fundamental difficulties with the notion that duties to negotiate have to be complied with in good faith.

If agreements to negotiate in good faith have become common practice, notwithstanding their uncertain nature, then it is necessary to consider their function. Agreements to negotiate are often concluded to provide some assurance that both parties are serious about negotiations and that the resources spent pursuant to negotiations will not be in vain.[101] This type of agreement can also serve as an "action-forcing" tool that prevents negotiations from stagnating.[102] The efficacy of negotiations is often affected by the actions of the parties, and agreements to negotiate may be concluded to discourage delaying tactics, opportunistic behaviour or non-participation that would unnecessarily prolong negotiations.[103] Agreements to negotiate can perform these functions irrespective of their enforceability. In terms of English law, the rationale for complying with this negotiation obligation is said to be based on morality and trust rather than the fear of contractual liability.[104]

It does not necessarily follow that an obligation to negotiate in good faith is always intended to be binding in honour only. It will become clear throughout the analysis in chapters 2[105] and 3 that the obligation to negotiate in good faith can perform different functions, depending on the type of agreement it forms a part of. Furthermore, the intended function of an obligation to negotiate in good faith can also lie in legally binding parties to a specific standard of conduct or obligations in the course of negotiations. Therefore as we move on to consider other types of agreements, it is important to bear in mind that the obligation to negotiate can arise in various types of

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[100] 2018 3 SA 76 (SCA); see discussion in ch 3 (3 2 2 1).

[101] A Schwartz & RE Scott "Precontractual Liability and Preliminary Agreements" (2007) 120 *Harv L Rev* 661 664,667; O'Connor 2010 *Tas L Rev* 184.

[102] M Watkins "Building Momentum in Negotiations: Time-related Costs and Action-forcing Events" (1998) 14 *Negotiation J* 241 248; O'Connor 2010 *Tas L Rev* 184.

[103] Schwartz & Scott 2007 *Harv L Rev* 667; O'Connor 2010 *Tas L Rev* 184.

[104] Trakman & Sharma 2014 *CLJ* 602.

[105] See ch 2 (2 3 2 1).

pre-contractual agreements and perform different functions.

2 3 Agreements outlining the terms of the envisaged main contract or reflecting partial agreement

This type of pre-contractual agreement outlines the terms of the envisaged main contract that is the subject of negotiation.[106] Unlike the previous category, it actually deals with the substance, and not merely with the process of negotiation. The structure and content of these types of agreements can vary, but they generally contain at least some of the key terms of the envisaged transaction.[107]

In *Teachers Insurance and Annuity Association of America v Tribune Co ("Tribune Co"),*[108] one of the leading American cases on pre-contractual agreements, Judge Leval classified these types of instruments into two main types of enforceable agreements. The type I pre-contractual agreement is a complete agreement containing all the essential elements of the main contract and is pre-contractual only in form and not in substance.[109] That is to say that parties may envisage conclusion of a more formal contract but this is not necessary for the validity of the agreement because consensus has been reached on all essential terms of the contract. As such, parties generally regard conclusion of a final agreement as preferable, but not necessary.[110] The type II pre-contractual agreement is an incomplete or partial agreement, often referred to as a contract to negotiate. This type of agreement does not bind the parties to their future intended contractual objective but does oblige parties to negotiate the remaining terms in good faith with a view to achieving that contractual objective.[111] This categorisation is theoretically useful, but in practice it is

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[106] Moss "Function of Letters of Intent" in *New Features in Contract Law* 141.

[107] JP Kostritsky "Uncertainty, Reliance, Preliminary Negotiations and the Hold-up Problem" (2008) 61 *SMU L Rev* 1377 1399.

[108] (1987) 670 F Supp 491 (S D N Y) 498.

[109] *Teachers Insurance and Annuity Association v Tribune Company* (1987) 670 F Supp 491 (S D N Y) 498; KM Shelley & JJ Toronto "Preliminary Agreements: How to Avoid Unintended Contractual Obligations" (2005) 25 *Franchise LJ* 47 48.

[110] *Teachers Insurance and Annuity Association v Tribune Company* (1987) 670 F Supp 491 (S D N Y) 498; SD Aaron & J Caterina "Contract Formation under New York Law by Choice or through Inadvertence" (2016) 66 *Syracuse L Rev* 855 861.

[111] *Teachers Insurance and Annuity Association v Tribune Company* (1987) 670 F Supp 491 (S D N Y)

difficult to predict with certainty how courts will classify a specific pre-contractual agreement.[112]

The function of a pre-contractual agreement depends on the intention with which the parties concluded the agreement.[113] Its function could for example lie in its full enforceability as a final contract recorded in an informal or abbreviated format, or in its non-binding nature as an interim agreement, indicating that parties are both serious and optimistic regarding the conclusion of the final contract.[114] A pre-contractual agreement could, however, also be no more than a gesture indicating interest in the envisaged transaction.[115] Alternatively, this type of pre-contractual agreement may function to oblige parties to negotiate in good faith with a view to concluding the final contract.[116] The different types of pre-contractual agreements dealing with the substance of the envisaged main contract and their functions are set out below.

2 3 1 Agreements with clauses negating legal liability

2 3 1 1 Introduction

A pre-contractual agreement can outline all the terms of the envisaged main contract, but fail to give rise to binding contractual obligations because the requisite *animus contrahendi* is absent. A pre-contractual agreement of this nature will generally contain clauses to the effect that the agreement "will not give rise to any contractual obligations,"[117] does not "constitute the final contract between the parties,"[118] "is subject to contract,"[119] or "is subject to condition precedents."[120]

If parties clearly indicate that their pre-contractual agreement is not intended to be contractually binding then it can give rise to no more than a moral obligation, binding

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498.

[112] G Klass *Contract Law in the USA* (2010) 100.

[113] Kostritsky 2008 *SMU L Rev* 1399.

[114] Kostritsky 2008 *SMU L Rev* 1399; SGM Stein & JJ Rhiner "Enforcing Letters of Intent and Handshake Agreements" (2000) 37 *Constr Law* 37 39.

[115] Gosfield 2003 *Real Prop Prob & Tr J* 106.

[116] Kostritsky 2008 *SMU L Rev* 1399.

[117] Moss "Function of Letters of Intent" in *New Features in Contract Law* 141.

[118] 141.

[119] CP Thorpe & JCL Bailey *Commercial Contracts: A Practical Guide to Deals, Contracts, Agreements, and Promises* (1996) 13-15.

[120] Lake & Draetta *Letters of Intent* 186.

in honour only.[121] In terms of the laws of the United States and English law, a clause clearly stipulating the non-binding nature of a pre-contractual agreement will generally operate to prevent any contractual obligations from coming into existence.[122]

2 3 1 2 Agreements made subject to a condition precedent

Pre-contractual agreements made subject to condition precedents require further attention due to the fact that these types of qualifications may operate to prevent legal obligations from coming into existence, but are not treated in the same manner in every jurisdiction. In contract law the term "condition" can have a number of different meanings, and it is necessary to establish the meaning within the specific context and jurisdiction.[123]

A pre-contractual agreement may outline all the terms of the envisaged main contract, but could be made subject to the occurrence of an uncertain event referred to as a condition precedent.[124] Pre-contractual agreements subject to condition precedents must be distinguished from valid conditional contracts that are binding, but not yet enforceable.[125]

The meaning and effect of a "condition precedent" as used in the specific pre-contractual agreement must be analysed to establish whether legally, the agreement is in fact distinguishable from a valid conditional contract. In this regard, it is worth noting that the name given to an agreement is not determinative of its legal nature;[126] consequently, labelling an agreement subject to a condition precedent a "pre-contractual agreement" may not prevent a finding that the agreement is in fact a valid conditional contract. Furthermore, there is often is a great disparity between the actual legal nature and consequences of an agreement, compared to what business professionals seek to achieve by concluding such agreements.

In terms of South African law, conditions qualify the operation and consequences of contractual obligations.[127] As a general rule the inclusion of a suspensive condition

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[121] R Sharrock *Business Transactions Law* 9 ed (2016) 87.

[122] Cardenas 2013 *NYU JL & Bus* 963.

[123] M Furmston & GJ Tolhurst *Contract Formation: Law and Practice* 2 ed (2016) 197.

[124] Draetta & Lake 1993 *Int'l Bus LJ* 858.

[125] 858.

[126] M Furmston, MT Norisada & J Poole *Contract Formation and Letters of Intent* (1998) 145.

[127] Van Huyssteen et al *Contract* 279.

in an agreement does not prevent contractual obligations from coming into existence.[128] South African courts have, however, recognised an exception to this rule.[129] Where a contract for the sale of land is made subject to a suspensive condition, a contractual relationship will come into existence but no contractual obligations will arise until the condition has been fulfilled.[130] This construction has been criticised and it is accepted that the general rule is to be preferred.[131] Therefore, business professionals who utilise conditions in pre-contractual agreements with the intention of negating all legal liability, may well find themselves bound by a conditional contract. Practically, however, it does not seem to make a difference whether the fulfilment of the condition brings enforceable contractual obligations into existence or renders existing contractual obligations enforceable. The outcome will be the same, unless of course it is argued that a condition in a pre-contractual agreement operates to prevent a contract from coming into existence (irrespective of whether the condition is fulfilled).

In terms of English law and American law, a condition precedent can operate to prevent contractual obligations from arising until the condition has been fulfilled.[132] Furmston, in the context of English law, discusses how parties often seek to delay the legal effect of a pre-contractual agreement by incorporating the condition of "obtaining board approval". It can be unclear what effect fulfilment of a condition will have on the legal character of a pre-contractual agreement and a number of American cases have addressed this issue.[133] The question arises whether approval of the board will give full contractual effect to the pre-contractual agreement as a final contract or whether it merely authorises the relevant negotiating party to continue negotiations towards the final definitive contract.[134] If the agreement amounts to a valid conditional contract, fulfilment of the condition would bring contractual obligations into existence.

Although a pre-contractual agreement may appear to be a valid conditional

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[128] 285.

[129] 284.

[130] Van Huyssteen et al *Contract* 284; see *Corondimas v Badat* 1946 AD 548 para 558.

[131] Van Huyssteen et al *Contract* 284.

[132] Furmston & Tolhurst *Contract Formation* 198; TC Homburger & JR Scheuller "Letters of Intent - A Trap for the Unwary" (2002) 37 *Real Prop Prob & Tr J* 509 514; see also *Quake Construction Inc v American Airline Inc* (1990) 565 NE 2d 990 994.

[133] Furmston & Tolhurst *Contract Formation* 193; see also Farnsworth 1987 *Colum LR* 248-249.

[134] Gosfield 2003 *Real Prop Prob & Tr J* 160-161.

contract, it may not be treated that way in practice. For example, in the construction industry, a contractor may agree to appoint a particular sub-contractor on condition that he secures the principal contract.[135] This appears to be a valid conditional contract. It is, however, accepted that most contractors do not treat it as such, and the parties will generally not resort to legal recourse if one of the parties decides not to continue with the agreement, even after the main contract has been awarded and the condition thus was fulfilled.[136]

Even if a condition can operate to prevent or delay a final contract from prematurely coming into existence, as it does in American law, it does not follow that the pre-contractual agreement fails to give rise to binding obligations before fulfilment of the condition itself.[137] A conditional pre-contractual agreement may still, for example, give rise to an obligation to negotiate the remaining terms in good faith.[138] In the American case of *A/S Apothekernes Laboratorium for Specialpraeparater v I.M.C Chemical Group,*[139] the court found that a letter of intent made subject to the approval of the board of directors could not give rise to a final contract for the envisaged transaction, but that it nonetheless imposed an obligation on parties to negotiate in good faith.[140] In establishing the function of a condition in a pre-contractual agreement it is necessary to examine whether the condition applies only to the provisional terms of the final contract as outlined in the pre-contractual agreement or to the entire pre-contractual agreement itself.[141] As is evident from the *Apothekernes* case, a condition will not necessarily deprive the entire pre-contractual agreement of legal force, even if it prevents the envisaged legal obligations from coming into existence pending fulfilment of the condition.

2 3 1 3 Agreements made subject to contract

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[135] Furmston & Tolhurst *Contract Formation* 194.

[136] Furmston & Tolhurst *Contract Formation* 194; see also R Lewis "Contracts between Businessmen: Reform of the Law of Firm Offers and an Empirical Study of Tendering Practices in the Building Industry" (1982) 9 *J Law & Soc* 153 163,166-167.

[137] Gosfield 2003 *Real Prop Prob & Tr J* 110.

[138] Draetta & Lake 1993 *Int'l Bus LJ* 840.

[139] (1989) 873 F 2d 155 (7th Cir) 157-158.

[140] See ch 2 (2 2 6) on agreements to negotiate in good faith.

[141] Gosfield 2003 *Real Prop Prob & Tr J* 110.

It is not uncommon for pre-contractual agreements to contain "subject to contract" clauses which may also prevent contractual obligations from coming into existence. This type of clause indicates that parties agree that neither of them shall be bound by the substantive agreement until it has been reduced to writing and signed by both the parties.[142] An informal agreement made subject to contract may be oral or recorded in a letter or memorandum which is not valid until signed by both the parties.[143] The phrase "subject to contract" is often used indiscriminately. A subject to contract clause may firstly indicate that an agreement is only intended to be binding once signed by both of the parties.[144] It is also possible that the agreement is merely an interim agreement that is not intended to be binding at all.[145] Lastly, such a phrase may merely indicate that some form of further approval is necessary.[146] A subject to contract clause is thus a broad and neutral term which can be used by the parties to specify the absence of contractual intent in relation to the business terms included in the pre-contractual agreement.[147]

In terms of English and American law, pre-contractual agreements subject to the execution of a formal contract are generally informal agreements outlining the key terms of the envisaged transaction; the precise contractual terms are generally left to be formulated by the parties' attorneys who will draft a final contract.[148] Where these types of pre-contractual agreements contain all the material terms, legal issues can arise.[149] Do parties intend to be immediately bound, the final written contract being preferable, but not a prerequisite, or do the parties only intend to be bound once that contract is concluded[150] There is an inherent risk that a court may in cases of ambiguity find that a binding final contract has come into existence.[151] Parties should still be

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[142] Sharrock *Business Transactions Law* 86.

[143] BA Blum & AC Bushaw *Contracts: Cases, Discussion, and Problems* 4 ed (2017) 166.

[144] Thorpe & Bailey *Commercial Contracts* 15.

[145] 15.

[146] 15.

[147] 15.

[148] Blum & Bushaw *Contracts* 166; M Furmston & J Adams *The Law of Contract* 4 ed (2010) 487-488.

[149] JM Perillo *Corbin on Contracts Revised Edition I: Formation of Contracts* §§ 1.1-4.14 (1993) 144; Furmston & Adams *Law of Contract* 488.

[150] Blum & Bushaw *Contracts* 166.

[151] Gosfield 2003 *Real Prop Prob & Tr J* 114.

aware that even if a pre-contractual agreement "subject to contract" does not give rise to a final contract, in terms of American law it may nonetheless be found to constitute a contract to negotiate in good faith.[152]

2 3 1 4 General functions of non-binding pre-contractual agreements

The analysis thus far indicates that while there are circumstances in which pre-contractual agreements with clauses negating liability can give rise to contractual obligations, they are generally non-binding in relation to the terms of the envisaged transaction.[153] This type of agreement is commonly referred to as a letter of intent, a memorandum of understanding or a term sheet.[154] These labels are generally used interchangeably. However, it should be noted that letters of intent and memoranda of understanding typically take on a narrative form, with less detail regarding the specific terms of the envisaged transaction, whereas term sheets tend to contain more specific details regarding the terms of the transaction.[155]

At first glance, non-binding agreements outlining the terms of the envisaged transaction seem somewhat contradictory because they outline all the terms of the envisaged transaction while containing a clause negating legal liability.[156] This apparent contradiction seems less pronounced if it is accepted that these types of pre-contractual agreements, despite their apparent similarities to a binding contract, are conceptually and functionally distinguishable. Bearing this in mind their various functions will now be considered.

(i) Organisation, framework and third party approval

An important function of non-binding pre-contractual agreements is to record consensus and establish the terms upon which parties are willing to proceed with negotiations.[157] It enables parties to communicate their intentions and make proposals without fear of creating unintended contractual obligations.[158] Pre-contractual

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[152] 114.

[153] Gosfield 2003 *Real Prop Prob & Tr J* 103,144; see 2 2 6 on agreements to negotiate in good faith.

[154] Harrison *Make the Deal* 48.

[155] 48.

[156] Moss "Function of Letters of Intent" in *New Features in Contract Law* 141.

[157] Denicolo *Acquisitions* para 2 3 1 1.

[158] Shelley & Toronto 2005 *Franchise LJ* 52.

agreements can also prevent misunderstandings or selective recollections regarding what has been agreed to, and can facilitate the negotiation and drafting of the final contract.[159] Perillo explains that a pre-contractual agreement, if properly utilised, serves as a "road-map" that could potentially lead to a final contract.[160]

Negotiations often take place between business professionals who will need to seek the advice of various experts before concluding a final contract. A pre-contractual agreement is useful because it records in a single document the key terms of the envisaged transaction. Each negotiating party can submit the agreement to their team of experts, such as accountants and lawyers, who will refine the terms and draft the final contract.[161] Pre-contractual agreements can also serve a very important function in obtaining third party finance, since lenders or investors may only be willing to provide a loan or investment if they are provided with some evidence that a contract is likely to be concluded.[162] A signed pre-contractual agreement is often a prerequisite for an approval of a loan necessary to finance the envisaged transaction.[163]

(ii) Commitment to negotiations, building trust and establishing moral obligations

A further potential function of non-binding pre-contractual agreements is to assist one party to establish the level of commitment and seriousness of the other party before investing a large amount of resources into negotiations.[164] If negotiating parties are able to reach consensus on the essential business terms of the envisaged transaction promptly, a negotiating party can be more assured that the other party is serious about negotiations and committed to resolving outstanding issues with a view to concluding a final contract.[165] In addition to conveying a commitment to negotiations, the conclusion and compliance with a series of non-binding pre-contractual agreements can build a relationship of trust between the parties and increase the likelihood of a

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[159] Jeffries 2012 *Gonz L Rev* 9; Aaron & Caterina 2016 *Syracuse L Rev* 866.

[160] *Corbin on Contracts* 46.

[161] Jeffries 2012 *Gonz L Rev* 9.

[162] Jeffries 2012 *Gonz L Rev* 9-10; RB Lake "Letters of Intent: A Comparative Examination under English, U.S., French and West German Law" (1984) 18 *Geo Wash J Intl L & Econ* 331 334.

[163] Jeffries 2012 *Gonz L Rev* 10.

[164] Jeffries 2012 *Gonz L Rev* 9; Perillo *Corbin on Contracts* 46.

[165] Jeffries 2012 *Gonz L Rev* 9.

final contract being concluded.[166]

Pre-contractual agreements also exert a certain level of moral pressure.[167] Parties often feel a moral obligation to comply with pre-contractual agreements.[168] The importance that many parties attach to upholding a reputation of conducting business with integrity often allows pre-contractual agreements to exert sufficient moral pressure for parties to abide by their terms.[169]

2 3 1 5 Fields of practical application

With the benefit of a theoretical classification of the different types of non-binding pre-contractual agreements that set out the terms of the envisaged contract, their practical application can now be considered. The focus will be on their use in the construction industry, and in mergers and acquisitions.

(i) Construction industry

Pre-contractual agreements, often referred to as letters of intent, are commonly used in the construction industry to fast-track the construction process.[170] These letters of intent generally do not have a set content or format, but will usually contain some term to the effect that the one party intends to conclude a contract for the envisaged transaction with the other party as soon as outstanding matters have been negotiated and the detailed contractual terms have been agreed upon.[171]

It is also possible that the letter of intent will include a clause instructing the other party to commence with the work envisaged by the future contract.[172] These types of agreements, in terms of English law, are generally phrased in a manner that ensures that no contractual obligations will arise.[173] If, however, the letter of intent contains a clause inviting a party to commence work, it may give rise to an obligation to provide

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[166] C Hwang "Deal Momentum" (2018) 65 *UCLA L Rev* 376 407; Van Huyssteen et al *Contract* 71.

[167] Hwang 2018 *UCLA L Rev* 409.

[168] See ch 2 (2 3 5).

[169] Hwang 2018 *UCLA L Rev* 409-410.

[170] R Knowles 200 *Contractual Problems and Their Solutions* 3 ed (2012) 71.

[171] R Van Deventer *The Law of Construction Contracts* (1993) 27-28; M Hogg *Obligations* 2 ed *(*2006) 71.

[172] Van Deventer *Construction Contracts* 28.

[173] M Furmston, GH Cheshire & CHS Fifoot *Cheshire, Fifoot and Furmston's Law of Contract* 17 ed (2017) 59.

remuneration for that work.[174]

The functions of these types of agreements are not always easy to identify because they do not have a standard content and can take on many different forms.[175] It can, however, be accepted that drafting a formal construction contract can be a lengthy and complex process, which will not necessarily meet the immediate needs of negotiating parties who wish for construction to commence as soon as possible.[176] Often, construction projects will have deadlines, requiring work to commence before negotiations are complete.[177] Parties may therefore resort to letters of intent as an interim measure prior to conclusion of the final contract to allow work to commence.[178]

Gilbreath, in his discussion of letters of intent in the context of American law, issued a warning against the use of these agreements, stating that they have limited value because they are often relied upon to delay the conclusion of a final contract and the resolution of outstanding matters.[179] Such delay is often due to a deadlock in negotiations, or difficulties in reaching consensus on outstanding terms, which prolongs the negotiation process and delays the commencement of work. Instead of resolving the deadlock on outstanding terms prior to the commencement of work parties use these agreements to avoid the deadlock and allow work to commence, despite the possibility that parties will not necessarily reach consensus on those outstanding terms. In the English case of *RTS Flexible Systems v Milkerei Alois Muller Gmbh*[180] Lord Clarke also emphasised the risks involved in commencing work pursuant to a letter of intent, and suggested that parties would be wiser to settle the terms of the construction contract first and start work later.

(ii) Mergers and acquisitions

In the context of mergers and acquisitions, term sheets or letters of intent are intended

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[174] 59.

[175] Van Deventer *Construction Contracts* 28.

[176] Knowles *200 Contractual Problems* 71; RD Gilbreath *Managing Construction Contracts: Operational Controls for Commercial Risks* 2 ed (1992) 142-143. This phenomenon can give rise to claims in the law of unjustified enrichment, in this regard see discussion in (ch 5) 5 3 5.

[177] J Adriaanse *Construction Contract Law* 4 ed *(*2016) 57.

[178] Adriaanse *Construction Law* 56; Gilbreath *Managing Construction Contracts* 143.

[179] Gilbreath *Managing Construction Contracts* 143.

[180] [2010] 1 WLR 753 para 1.

to provide a summary of the envisaged merger transaction so that there is consensus between the parties regarding the general outline of the transaction before they proceed with more detailed transaction documents.[181] These agreements are brief and generally outline a few material business terms such as the subject matter of the transaction and the price.[182] This agreement can be unsigned or signed.[183] Term sheets or letters of intent in the context of American mergers and acquisitions are generally non-binding and serve as no more than a summary of the negotiating parties' position and as a guideline for drafting a more formal merger and acquisition contract.[184]

Term sheets and letters of intent perform an important function in the merger and acquisition negotiation process, but the potential limitations of these types of agreements cannot be ignored. In complex negotiations requiring great attention to detail, term sheets or letters of intent can be less efficient, because they only outline the transaction in broad terms and build up momentum towards the envisaged transaction, even though the more nuanced details of the contractual relationship have not been negotiated. [185] If a term sheet only deals with the envisaged transaction in a superficial manner and overlooks complex details that are material to the conclusion of the envisaged transaction, unresolvable disputes can arise at a late stage in the negotiation process.[186] This leads us to consider partial or incomplete agreements that only outline some of the terms of the contract with various levels of detail.

2 3 2 Partial (inchoate) or incomplete agreements

In many cases, negotiations and contract formation occur almost instantaneously, because the former are straightforward and very limited.[187] Traditional contract law rules are well developed to cater for these types of transactions. However, as modern commerce continues to grow and develop, transactions are becoming larger and

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[181] Harrison *Make the Deal* 8.

[182] Hwang 2018 *UCLA L Rev* 380.

[183] 380.

[184] Harrison *Make the Deal* 8.

[185] 48.

[186] 48.

[187] M Furmston "Letters of Intent" in A Burrows & E Peel (eds) *Contract Formation and Parties* (2010) 17 18.

increasingly complex.[188] Negotiations can persist over many years and may require the involvement of numerous teams of experts for each of the negotiating parties.[189] As a result, it is often necessary for different stages of negotiations to be dealt with individually.[190] Partial or provisional agreements are utilised to perform this function and record consensus reached at a specific stage of negotiations.[191] They enable parties to record and set aside the specific terms of the transaction that have been successfully negotiated and facilitate negotiations on the outstanding, potentially problematic terms.[192] Furthermore, they are useful memoranda for parties to refer back to in lengthy negotiations where they do not necessarily recall what was agreed upon early in the negotiation process. Against this background we shall now turn our attention to a more detailed analysis of the function of these types of agreements.

2 3 2 1 The formalisation of agreed-upon terms and the imposition of an obligation to negotiate remaining terms in good faith

In American law, a partial agreement serves a vital function in practice because it allows negotiating parties to formalise aspects already negotiated, while retaining the freedom not to conclude a final contract until all elements of the intended transaction have been negotiated and the economic benefit of the transaction has been evaluated.[193] Parties are not bound to conclude the final contract, but if it is concluded the pre-contractual agreement is highly beneficial in preventing negotiations being re-opened on terms already agreed upon.[194] On this understanding, parties to a partial agreement agree that if the final contract is concluded, the terms already negotiated and agreed upon in the partial agreement should be incorporated into the final contract.[195]

Writing in the context of American law, Moss has argued that a party will be liable for breach of contract if such a party insists on concluding the final contract without

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[188] 18.

[189] 18.

[190] AJ Kerr *Principles of Contract Law* 6 ed (2002) 62.

[191] G Bradfield *Christie's Law of Contract in South Africa* 7 ed (2016) 43.

[192] Bradfield *Law of Contract* 43; Fontaine & De *Ly Drafting International Contracts* 145.

[193] Moss "Function of Letters of Intent" in *New Features in Contract Law* 142.

[194] 145.

[195] 145.

incorporating the terms already agreed upon.[196] Other scholars like Draetta and Lake argue that an agreement must be evaluated as a whole - if the terms agreed upon in the partial agreement cannot be enforced as a final contract, then the enforceability of those agreed upon terms depends upon further negotiation on the outstanding aspects.[197] There is American case law however that supports the proposition that a partial agreement imposes an obligation on parties not to reopen negotiations on those aspects already agreed upon.[198] Irrespective of the prevailing legal position, negotiating parties can easily circumvent an obligation not to reopen negotiations on aspects previously agreed upon by simply failing to reach final agreement on the outstanding aspects, and in doing so avoid any obligation altogether.[199]

In light of the ease with which the above-mentioned obligations can be circumvented it is necessary to consider other potential functions that can be served by an agreement of this nature. It has been suggested that the function of a partial agreement in American law may be to impose a standard of behaviour upon parties in the course of negotiating the outstanding terms of the envisaged transaction. Some partial agreements, for example, contain an express or implied obligation to negotiate the remaining terms in good faith.[200] While this may very well be the intended function of a partial agreement, its efficacy in regulating the behaviour of the parties may depend on the enforceability of an agreement to negotiate in good faith.[201]

2 3 2 2 A non-binding "road map" towards the conclusion of the final contract

In terms of South African law, even if consensus has been reached on some of the essential terms of the contract, a valid contract will not come into existence if the parties only intend to be bound once all material terms have been agreed upon.[202] Even if contractual obligations do not arise, a partial agreement may nonetheless

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[196] 150.

[197] Draetta & Lake 1993 *Int'l Bus LJ* 854.

[198] See e.g. *Teachers Insurance Annuity Association of America v Tribune Co* (1987) 670 F Supp 491 (S D N Y) 498.

[199] Draetta & Lake 1993 *Int'l Bus LJ* 852.

[200] Moss "Function of Letters of Intent" in *New Features in Contract Law* 151.

[201] See ch 3 regarding the enforceability of agreements to negotiate in good faith.

[202] Sharrock *Business Transactions Law* 84; *OK Bazaars v Bloch* 1929 WLD 37 42-43; see also ch 3 for further discussion on the legal consequences of partial/inchoate agreements.

assist parties towards a final contract. For example, in *Titaco v AA Alloy Foundry*[203] the parties had recorded the framework for the envisaged settlement transaction but there were a number of material aspects that required further negotiation. In this case the agreement functioned to set out, in a non-binding document, terms already agreed upon so that the parties could focus discussions on the outstanding material terms which required negotiation.[204] In *Pitout v North Cape Livestock Co-operative Ltd*[205] the court explained that a non-binding agreement may be concluded, in the course of negotiations, as the parties are "feeling their way towards a more precise and comprehensive agreement".[206]

2 3 2 3 An agreement that is intended to be immediately binding

In terms of South African law, it is also possible for a so-called "partial" agreement to give rise to contractual obligations. Parties may intend for their partial agreement to constitute a binding preliminary contract for the envisaged transaction, notwithstanding the fact that they contemplate the conclusion of a subsequent contract or have left outstanding matters regarding the envisaged transaction to future negotiation.[207] In *CGEE Alsthom Equipments et Enterprises Electriques, South African Division v GN Sankey (Pty) Ltd*[208] Corbett JA stated the following:

> "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".[209]

If the parties fail to reach consensus regarding the outstanding terms of the contract then the original interim contract will prevail.[210] It is therefore clear that in terms of South African law there are circumstances where a partial agreement may acquire contractual force.

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[203] 1996 3 SA 320 (W) 331, 333, 334-335.

[204] Sharrock *Business Transactions Law* 84.

[205] 1977 4 SA 842 (A) 850D-G.

[206] 850D.

[207] Sharrock *Business Transactions Law* 85.

[208] 1987 1 SA 81 (A).

[209] 92C-D.

[210] 91A-92E.

In terms of American law, a partial agreement could be recognised as a so-called agreement with "open terms".[211] Farnsworth explains that this type of agreement imposes an obligation to negotiate the remaining terms in good faith and conclude the final contract.[212] If parties fail to reach agreement on outstanding terms, the court will supply them.[213]

It is clear from this comparative assessment that a partial agreement could potentially be a non-binding agreement, a binding contract for the envisaged transaction (if it has sufficient contractual content) or an agreement imposing an obligation to negotiate the remaining terms in good faith.[214] How courts interpret this type of agreement will depend upon the specific jurisdiction in question. In terms of American law, courts are much more hesitant to enforce a pre-contractual agreement as a final contract than to enforce a pre-contractual agreement as a contract to negotiate. [215] In terms of South African law, whether a partial agreement is a binding contract or merely a non-binding instrument through which parties work their way towards a final agreement will depend upon their intention.[216]

2 3 3 Preliminary contracts outlining the envisaged terms

A pre-contractual agreement may have been concluded in circumstances where parties have reached consensus on all outstanding matters and, as far as the parties are concerned, negotiations have been exhausted.[217] This distinguishes this type of agreement from a partial preliminary contract.[218] Parties may have reached complete agreement regarding all the essential terms requiring negotiation and while the conclusion of more formal final contract may have been provided for in their original

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[211] Farnsworth 1987 *Colum LR* 250 253.

[212] 250, 253.

[213] 250.

[214] See ch 2 (2 2 6) on agreements to negotiate in good faith.

[215] Draetta & Lake 1993 *Int'l Bus LJ* 844.

[216] CGEE *Alsthom Equipments et Enterprises Electriques, South African Division v GN Sankey (Pty) Ltd* 1987 1 SA 81 (A) 9E-F; see also *Pitout v North Cape Livestock Co-operative Ltd* 1977 4 SA 842 (A) 850D-G.

[217] J Klein & C Bachechi "Precontractual Liability and the Duty of Good Faith Negotiations in International Transactions" (1994) 17 *Hous J Int'l L* 1 9.

[218] See ch 2 (2 3 2).

agreement, it is not necessary that this should occur.[219] Judge Leval, in the American case of *Tribune Co* [220] described this agreement as the type I pre-contractual agreement,[221] which is treated as a complete and final contract. Often these types of preliminary contracts are erroneously labelled as a letter of intent because they contemplate the conclusion of a more formal contract containing the so-called "boilerplate" provisions.[222]

2 3 4 Form agreements

Pre-contractual agreements can serve to unify the negotiation process by providing a framework for all future contracts that the negotiating parties intend to conclude in the course of their business relationship.[223] This type of pre-contractual agreement is known as a "form agreement" and it is generally concluded by parties who foresee that their business relationship will require the conclusion of a substantial volume of similar contracts, each of which will require individual negotiation with terms that do not necessarily coincide.[224] As the business relationship progresses and business operations become larger and the performance more complex, the negotiating parties will realise the need for standardisation in relation to the various contracts concluded.[225] The type of contracts being dealt with are usually for the large scale sale of goods and services. Both the buyer and seller will have "general conditions" of purchase and sale respectively which may be different or even conflicting.[226] In light of the fact the parties envisage a long term business relationship, a substantial amount of time and resources will be spent, in the duration of their relationship, on individually negotiating each contract and harmonising their general conditions.[227]

In this type of scenario, negotiating parties may choose to meet and settle all the

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[219] Jeffries 2012 *Gonz L Rev* 21.

[220] (1987) 670 F Supp 491 (S D N Y) 498.

[221] For detailed discussion see 2 3

[222] Lake & Draetta *Letters of Intent* 16.

[223] Schmidt 1983 *Hous J Int'l L* 54.

[224] 54.

[225] 54.

[226] Schmidt 1983 *Hous J Int'l L* 55. Parties will have general conditions that they incorporate into contracts for the sale or purchase of products or services and this will often give rise to a battle of forms.

[227] General conditions can relate to the price of goods and services, choice of law, orders and specifications and intellectual property - see J Cox (ed) *Business Law* 6 ed (2015) 334-336.

general terms of the numerous future contracts in a form agreement which will impose the agreed upon framework on all future contracts.[228] Form agreements establish the rules for the negotiation of future agreements and standardise the subject matter (goods or services) of future contracts.[229] In the context of a supply contract, a form agreement may impose conditions regarding the organisation of transport, deliveries, payment and insurance, which are to be included in the supply contract.[230] The general function of form agreements is thus to create obligations in relation to the method of concluding future contracts and the general terms of performance that will be included in such contract.[231]

2 3 5 Academic debate regarding the true function of pre-contractual agreements

From our analysis thus far, it is clear that pre-contractual agreements can be intended to be non-binding in relation to the terms of the envisaged transaction. Various clauses negating legal liability are included to indicate this, and parties often go to great lengths to emphasise their wish not to be bound.[232] This raises the following question: why do sophisticated business parties choose to go to the time and legal expense of concluding pre-contractual agreements if they are generally not legally enforceable? The general functions of non-binding agreements have been briefly discussed above with reference to specific practical applications.[233] Further analysis, however, highlights the existence of alternative explanations for the use of pre-contractual agreements. This is important, particularly in light of the recent trend in prominent jurisdictions to assign some contractual consequences to pre-contractual agreements on the basis that enforcement is necessary for their function to be fulfilled.

Some of the existing academic literature on pre-contractual agreements proceeds from the assumption that a pre-contractual agreement must be a type of enforceable contract in order to perform its various functions.[234] We must there consider the functions of enforceable pre-contractual agreements, as put forward by academics

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[228] Schmidt 1983 *Hous J Int'l L* 55.

[229] 55.

[230] 55.

[231] 57.

[232] See ch 2 (2 3 1) on clauses negating legal liability.

[233] See ch 2 (2 3 1 4).

[234] Hwang 2018 *UCLA L Rev* 381; see e.g. Schwartz & Scott 2007 *Harv L Rev* 661 671.

who argue in favour of their enforceability. However, before proceeding with this section it must be acknowledged that there is an overlap between the above discussion of the practical functions of pre-contractual agreements as analysed from a commercial perspective and the academic proposals which will now be considered.[235] It will be observed that academic proposals around the functions of these agreements will go further than merely identifying functions that are immediately apparent and will look at the more nuanced aspects of pre-contractual agreements.

There are two main theories regarding the function of pre-contractual agreements and both regard judicial enforcement as a central component.[236] The first theory is that pre-contractual agreements resolve uncertainty regarding the transaction.[237] The second theory is that pre-contractual agreements resolve transaction complexity.[238]

Schwartz and Scott argue that pre-contractual agreements resolve transaction uncertainty.[239] In the course of early negotiations there is uncertainty regarding the cost and benefit of the envisaged transaction for the respective parties.[240] Complex negotiations often require relationship-specific investments to resolve uncertainty and to determine the profitability of the envisaged transaction.[241] A negotiating party is often hesitant to make such investments for fear that these may be in vain if the other party behaves opportunistically or arbitrarily terminates negotiations.[242] For this reason, parties formalise their relationship by concluding an agreement to negotiate which outlines the key terms of the transaction at a time where uncertainty prevents the conclusion of a final contract.[243] If such an agreement is enforceable as a contract to negotiate in good faith it can function as the security necessary to give a negotiating party the peace of mind to make the necessary investments to resolve uncertainty.[244] Enforceable contracts to negotiate in good faith can protect reliance investments and

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[235] See ch 2 (2 3 4 1 1).

[236] Hwang 2018 *UCLA L Rev* 384.

[237] 384.

[238] 384.

[239] Schwartz & Scott 2007 *Harv L Rev* 663; Hwang 2018 *UCLA L Rev* 387.

[240] Kostritsky 2008 *SMU L Rev* 1378.

[241] Schwartz & Scott 2007 *Harv L Rev* 663.

[242] 662-663.

[243] Hwang 2018 *UCLA L Rev* 381.

[244] Schwartz & Scott 2007 *Harv L Rev* 667, 703-704.

discourage strategic behaviour and the termination of negotiations without cause.[245]

Choi and Triantis support the second theory of the reduction in transaction complexity, arguing that the function of pre-contractual agreements is to assist parties who are engaged in complex negotiations that require the negotiation of multiple issues between a number of different parties.[246] Dividing the negotiation process into more manageable stages simplifies an otherwise complex transaction and allows both parties to involve experts in the process.[247] Choi and Triantis, like Schwartz and Scott, believe that pre-contractual agreements must at least be enforceable to some extent, otherwise parties will not be incentivised to comply and the intended function will not be achieved.[248]

Hwang, in her study of pre-contractual agreements in the deal-making process, puts forward an alternative explanation for the function of pre-contractual agreements which does not require enforceability for their efficacy.[249] She argues that while the two main theories regarding the functions and enforceability of pre-contractual agreements seem convincing, they fail to explain why parties often choose to conclude non-binding agreements that explicitly exclude judicial involvement.[250] Furthermore these explanations fail to explain why, in practice, parties generally comply with non-binding pre-contractual agreements by concluding a final contract on substantially the same terms. [251]

Hwang proceeds on the assumption that sophisticated parties involved in merger and acquisition negotiations have access to the skills and resources necessary to conclude a main contract, but consciously elect to utilise a pre-contractual instrument.[252] Pre-contractual agreements must therefore perform a function distinct from a contract, otherwise parties would not go to the time and expense of concluding both in order to conclude the intended transaction. Hwang puts forward the proposition that pre-contractual agreements are not actually concluded to resolve uncertainty or

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[245] Schwartz & Scott 2007 *Harv L Rev* 667, 687*;* Kostritsky 2008 *SMU L Rev* 1400.

[246] Hwang 2018 *UCLA L Rev* 382, 388-389.

[247] 382, 389.

[248] 382.

[249] 380.

[250] 382; non-judicial means of enforcement will be considered in ch 4.

[251] Hwang 2018 *UCLA L Rev* 382.

[252] 381.

complexity; and that they are in fact concluded at a time when most of the uncertainty and complexity regarding the transaction has been resolved through due diligence.[253] Existing academic literature assumes, sometimes erroneously, that all pre-contractual agreements are concluded very early on in the negotiation process; however, in the context of mergers and acquisitions, a pre-contractual agreement is generally only concluded once most of the transactional uncertainty has been resolved.[254]

On this understanding, it can be argued that pre-contractual agreements could also be concluded to serve as an indicator that the intended transaction is likely to be concluded and to organise the transaction.[255] Hwang describes pre-contractual agreements as a "sign post" for the accumulation of deal momentum.[256] If pre-contractual agreements are regarded as an indicator of the progression of negotiations to a stage where the contract is likely to be concluded, it explains why parties choose to adhere to the pre-contractual agreement and are willing to conclude the final contract on substantially the same terms.[257] Hwang proceeds to explain that in addition to performing this signalling function, pre-contractual agreements also perform other distinct formal functions that provide much needed structure to the negotiation phase, namely organisation, building trust and the imposition of moral obligations.[258] These functions have already been discussed above and do not require further elaboration.[259] The formal functions of pre-contractual agreements are potentially more valuable than their supposed "substantive function" (their resemblance to a contract and their enforcement as such).[260]

Most of the existing academic literature seems to rely on the similarities between a pre-contractual agreement and a contract when trying to ascertain the function of the former. This may well contribute to a growing misconception regarding the true purpose sought to be achieved by pre-contractual agreements in practice.[261] If parties

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[253] 382.

[254] 401-403.

[255] 382.

[256] 400.

[257] 383.

[258] 401, 406-408.

[259] See ch 2 (2 3 1 5).

[260] Hwang 2018 *UCLA L Rev* 401, 405.

[261] 379-381, 401.

prefer to comply voluntarily with non-binding agreements even in the absence of a fear of judicial enforcement, then the desire to categorise certain pre-contractual agreements as a type of contract merely because they resemble a contract needs to be re-evaluated.[262] It also becomes necessary to focus on the alternative explanations for the use of pre-contractual agreements that do not involve judicial enforcement.

Holten is another scholar who, like Hwang, looks to an alternative explanation for the use of pre-contractual agreements, conceding that most of these agreements exclude the involvement of the legal system.[263] However, he argues that none of the formal functions discussed thus far adequately explain the utility of pre-contractual agreements.[264] These agreements are notoriously vague and ambiguous because they are unavoidably incomplete regarding the envisaged transaction.[265] Holten suggests that the functions of these type of agreements lie in their inherent vagueness and ambiguity.[266] At the time when a pre-contractual agreement is concluded, parties are often unsure what they wish the outcome of negotiations to be.[267] At this stage it is impractical for parties to try and reach a compromise on concrete terms.[268] The vagueness of this agreement allows the negotiating parties to avoid direct confrontation or deadlock while they are still deciding on the terms upon which they would be willing to proceed with the envisaged transaction.[269]

Pre-contractual agreements, due to their vagueness and ambiguity, can also be utilised as a form of "economic hostage exchange".[270] This is a term used to describe a situation where both parties place themselves in a position of exposure and in doing so establish a relationship of mutual reliance.[271] The legal nature of pre-contractual agreements are uncertain, and by concluding such an agreement, parties expose

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[262] 400.

[263] JA Holten "Letters of Intent in Corporate Negotiations: Using Hostage Exchanges and Legal Uncertainty to Promote Compliance" (2014) 162 *U Pa LR* 1237 1253-1254.

[264] 1249.

[265] Gosfield 2003 *Real Prop Prob & Tr J* 101.

[266] Holten 2014 *U Pa LR* 1240.

[267] Unlike Hwang, Holten seems to accept that pre-contractual agreements are concluded at an early stage in the negotiation process.

[268] Gosfield 2003 *Real Prop Prob & Tr J* 101.

[269] Holten 2014 *U Pa LR* 1240.

[270] 1254.

[271] 1254.

themselves to the uncertain legal consequences that may flow from non-compliance.[272] This creates a state of mutual reliance where each party is potentially equipped to cause harm to the other party if that party does not comply with the agreement.[273] If pre-contractual agreements are employed to manipulate the uncertainty regarding their legal nature so as to elicit compliance, then their function is to act as a form of economic hostage exchange.[274] On this understanding of a pre-contractual agreement, it can be regarded as a bargaining tool. In this regard it should also be noted that pre-contractual agreements can also be manipulated in a similar manner by one party to exert moral pressure on the other party to abide by the agreement.

According to Holten, pre-contractual agreements may not give rise to a binding contract but they do create a higher level of commitment in negotiations.[275] Parties are generally unable to calculate the exact cost of terminating negotiations due to uncertainty regarding the legal consequences of pre-contractual agreements and the wide range of possible damages that may be awarded for breach if such agreement is recognised as a contract in the specific legal system.[276] As a result, it is challenging for the parties to evaluate whether pursuing an alternative to a final contract would be preferable.[277] Non-compliance with a pre-contractual agreement is therefore a risky action for either of the parties to take.[278] On the assumption that negotiating parties are risk averse, there is an increased likelihood that parties will rather choose to comply with the pre-contractual agreement.[279]

It can be argued that the uncertain legal character of pre-contractual agreements discourage parties from behaving opportunistically or strategically and ultimately make the envisaged transaction more likely to occur.[280] Thus, Holten's argument also seems to support the conclusion that even if pre-contractual agreements are not

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[272] 1256.
[273] 1256.
[274] 1257
[275] 1257.
[276] 1257-1258.
[277] 1258-1259.
[278] 1257.
[279] 1259.
[280] 1259.

intended to be a type of contract, they can still perform functions that are highly valued in practice.

2 4 Pre-contractual agreements and *pacta de contrahendo*

A *pactum de contrahendo* can be defined as a contract "aimed at the conclusion of another contract".[281] Pre-contractual agreements can be regarded as conceptually similar to *pacta de contrahendo* in the sense that they are agreements made between negotiating parties in an attempt to navigate their way towards a final contract.[282] These types of agreements, as seen above, can give rise to obligations regarding negotiations, but most are clearly distinguishable from *pacta de contrahendo*. Pre-contractual agreements and *pacta de contrahendo* are generally regarded as distinct legal concepts, but there can nonetheless be an overlap.[283] This will be discussed in chapter 3. Whether a pre-contractual agreement constitutes an enforceable agreement to contract depends upon the manner in which the specific jurisdiction defines and interprets the *pactum de contrahendo* concept.[284]

In terms of German law, when the basic terms regarding the main contract have been agreed upon, a bilateral pre-contract (*Vorvertrag*) can be entered into, notwithstanding the fact that certain issues require further negotiation or elaboration.[285] For such a valid pre-contract to come into existence, it must either contain all the essential elements of the main contract or a mechanism that renders those elements determinable.[286] A pre-contract constitutes a binding contract and imposes upon the parties an obligation to enter into the final contract.[287] A pre-contract is therefore a legally binding contract to enter into the main contract.[288]

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[281] Van Huyssteen et al *Contract* 70.

[282] H Peter & JC Liebeskind "Letters of Intent in the M & A Context" in G Kaufmann-Kohler & A Johnson (eds) *Arbitration of Merger and Acquisition Disputes: Swiss Arbitration Association Conference in Zurich of January 21, 2005* (2005) 265 268.

[283] 269.

[284] Van Huyssteen et al *Contract* 70-71.

[285] Tremml "The Acquisition of Companies" in *Key Aspects of German Business Law* 44; T Naudé *The Legal Nature of Preference Contracts* LLD thesis Stellenbosch University (2003) 1 8.

[286] 79.

[287] 44.

[288] B Markesinis, H Unberath & A Johnston *The German Law of Contract: A Comparative Treatise* 2 ed

South African law, by contrast, only categorises two types of contracts as enforceable *pacta de contrahendo,* namely preference contracts and option contracts.[289] Naudé explains that option and preference contracts can be described as "unilaterally binding"[290] and this makes them clearly distinguishable from the typical pre-contractual agreements above which are "bilaterally binding", whether contractually or otherwise. Furthermore, the problem with option and preference contracts is not whether they give rise to liability, but rather to determine some very specific remedial consequences; these consequences have been the subject of extensive commentary,[291] and need not be considered in this thesis.

It is clear from the consideration of the *Vorvertrag,* in the context of German law, that agreements binding both parties to conclude a contract in the future are recognised in some foreign legal systems as enforceable *pacta de contrahendo*.[292] In South African law, these types of agreements would generally constitute unenforceable agreements to agree. While concepts akin to the German pre-contract are not unknown to South African contract law, their application and validity are considerably limited by the certainty requirement.[293] When conducting comparative analysis, it is necessary to understand and interpret the *pactum de contrahendo* concept with reference to the specific context in which it is used. Ultimately, some jurisdictions would interpret the *pactum de contrahendo* concept so broadly that it includes types of pre-contractual agreements which other jurisdictions will treat as unenforceable agreements to agree.[294]

2 5 Conclusion

Pre-contractual agreements are often used when parties do not wish to enter into a final contract, but nonetheless want to explore the possibility of concluding the envisaged transaction.[295] The term "pre-contractual agreement" describes a vast

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(2006) 78.

[289] LF Van Huyssteen & CJ Maxwell *Contract Law in South Africa* 6ed (2019) para 58.

[290] See Naudé *The Legal Nature of Preference Contracts* 1 8.

[291] 1-8.

[292] 8.

[293] Van Huyssteen & Maxwell *Contract Law* para 58.

[294] Van Huyssteen et al *Contract* 71.

[295] NS Kim *The Fundamentals of Contract Law and Clauses: A practical Approach* (2016) 48.

variety of agreements with different legal content and functions, and it is not possible to describe every possible type of pre-contractual agreement. In fact a Working Group on International Contracts identified 26 variations of pre-contractual agreements collectively referred to as "letters of intent" in their study.[296] This chapter sought to derive from the mass of agreements referred to as "pre-contractual", two overarching categories that would allow a structured analysis of the functions and legal consequences of these agreements.

While the preceding discussion of the classification of pre-contractual agreements distinguished between agreements which gave rise to binding obligations in the course of negotiation and those which dealt with the envisaged transaction itself, in practice pre-contractual agreements usually contain a combination of binding and non-binding provisions.[297] Provisions intended to impose confidentiality, exclusivity or good faith obligations may therefore be contained in an otherwise non-binding document outlining the terms of the envisaged transaction.[298] This makes it more difficult to determine whether a particular pre-contractual agreement gives rise to contractual liability.[299] Agreements outlining the envisaged terms of the transaction can contain various clauses which indicate that they are non-binding in respect of the envisaged transaction but this will not necessarily exclude the possibility that such an agreement will impose an obligation to negotiate in good faith, at least in terms of American law.[300] It is therefore necessary to study each type of pre-contractual agreement to determine if it can give rise to contractual liability and if so what the nature of such contractual liability is.

The different types of pre-contractual agreements perform very distinct functions. The functions sought to be performed by conclusion of a pre-contractual agreement has a significant impact on whether a pre-contractual agreement requires contractual enforcement. For example, agreements imposing limited obligations regarding the negotiations[301] are generally binding contracts and require enforcement for their

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[296] Fontaine & De Ly *Drafting International Contracts* 5.

[297] Gosfield 2003 *Real Prop Prob & Tr J* 103 144.

[298] NS Kim *Fundamentals of Contract Law* 49.

[299] Gosfield 2003 *Real Prop Prob & Tr J* 103.

[300] NS Kim *Fundamentals of Contract Law* 49.

[301] See ch 2 (2 2).

function to be performed. Agreements outlining the terms of the envisaged transaction, by contrast, perform a number of formal functions which do not require contractual enforcement for their efficacy. The type of pre-contractual agreement and its intended function weighs heavily in determining whether such agreement should constitute a valid contract. With the benefit of an insight into the classification and functions of the different types of pre-contractual agreements, the question whether they can give rise to contractual liability can now be considered.

Chapter 3: Pre-contractual agreements and the requirements for contractual liability

3 1 Introduction

The terminology "pre-contractual" suggests that the types of agreements examined in this thesis constitute something less than a contract. However, it cannot be assumed, without more, that the diverse range of instruments constituting "pre-contractual agreements" fail to give rise to contractual obligations. While these instruments are often called "pre-contractual", the label given to them by the parties is not conclusive. The types of pre-contractual agreements described in the previous chapter will therefore be individually examined to determine whether they meet the requirements for a valid contract, and consequently give rise to contractual liability.

Before engaging in this analysis, it is necessary to make some preliminary observations regarding the classical rules of contract formation. Offer and acceptance, the traditional mechanism regulating contract formation, is not an effective means of establishing the legal consequences of pre-contractual agreements. Farnsworth, in his discussion of pre-contractual agreements in the context of American law, explains that complex commercial contracts are generally a product of protracted negotiations, and that consensus is reached in a piecemeal fashion through the conclusion of several successive agreements.[1] In this type of situation, the agreement in question often does not record an identifiable offer and acceptance.[2] In South African contract law, it is recognised that the offer-and-acceptance mechanism is merely a tool for establishing that there is a meeting of the minds, as opposed to a prerequisite for determining whether a contract has come into existence.[3] It is accepted that there are many examples of contract formation that cannot be properly analysed by way of offer and acceptance.[4]

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[1] "Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 *Colum LR* 217 218-219.

[2] 219.

[3] G Quinot "Offer, Acceptance and the Moment of Contract Formation" in HL MacQueen & R Zimmermann (eds) *European Contract Law: Scots and South African Perspectives* (2006) 74 75.

[4] 76.

It has been suggested that a more precise analysis of pre-contractual agreements can be achieved with reference to two requirements.[5] The first is that the agreement must be sufficiently certain and the second is that it must reflect the intention of the parties to be bound (i.e. an *animus contrahendi*).[6] In this chapter, these two requirements will be considered before proceeding in the next chapter to evaluate the contractual consequences (if any) of pre-contractual agreements. There is a close connection between the two requirements, however, because uncertainty can indicate an absence of *animus contrahendi*.[7] The two requirements are applied separately below, because even if an agreement is certain, parties may nonetheless manifest an intention not to be bound until a final contract is concluded.[8] Alternatively an agreement may give rise to a binding contract, notwithstanding some uncertainty or incompleteness, because the parties have expressed an intention to be bound.[9]

In applying these validity requirements to pre-contractual agreements, some systems adopt an "all or nothing" approach.[10] According to this approach, courts will often be forced to categorise pre-contractual agreements either as principal contracts or as agreements that do not give rise to contractual obligations at all, even in circumstances where these agreements do not fit properly into either of these categories in the sense that they may not constitute final contracts but are nevertheless intended to be binding.[11] This line of thinking will be expanded upon throughout this chapter. It is noted that these types of agreements may support the imposition of pre-contractual liability from other sources, such as the law of delict and the law of unjustified enrichment,[12] but that this may not meet the commercial

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[5] M Furmston, MT Norisada & J Poole *Contract Formation and Letters of Intent* (1998) 154.

[6] 155.

[7] JM Perillo *Corbin on Contracts Revised Edition I: Formation of Contracts §§ 1.1-4.14* (1993) 131; R Bradgate "Formation of Contract" in M Furmston (gen ed) *The Law of Contract* 4 ed (2010) 465-466.

[8] Perillo *Corbin on Contracts* 131; Bradgate "Formation of Contract" in *Law of Contract* 465-466.

[9] Perillo *Corbin on Contracts* 131.

[10] A Hutchison *"*Liability for Breaking off Contractual Negotiations*"* (2012) 129 *SALJ* 104 105; U Draetta & RB Lake "Letters of Intent and Pre-Contractual Liability" 1993 *Int'l Bus LJ* 835 836; HL Temkin "When Does the 'Fat Lady' Sing?: An Analysis of 'Agreements in Principle' in Corporate Acquisitions" (1986) 55 *Fordham L Rev* 125 142; E Pannebakker *Letter of Intent in International Contracting* LLD thesis Eramus University Rotterdam (2016)160.

[11] Temkin 1986 *Fordham L Rev* 142.

[12] See ch 5.

expectations of the parties.[13] Knapp supports the recognition of what he describes as an "intermediate stage" of contract formation, which occurs between negotiations and conclusion of a final contract.[14] This intermediate stage of contracting would require the recognition and enforcement of contracts to negotiate.[15]

Courts could concede that the specific pre-contractual agreement constitutes something less than the final contract, but avoid potentially inequitable results by concluding that the agreement nonetheless gives rise to intermediate obligations regarding negotiation of the envisaged principal contract.[16] Furthermore, this construction would allow courts to give effect to the true intention of the parties.[17] The possibility of recognising such an intermediate phase in South African contract law will be evaluated here.

Lastly, it is important once again to draw attention to the distinction between the types of pre-contractual agreements outlined in the previous chapter.[18] Pre-contractual agreements seeking to impose limited obligations such as confidentiality or exclusivity are relatively unproblematic and are generally regarded as binding contracts in most jurisdictions.[19] The application of the requirements for contractual liability to these agreements will therefore be brief. In contrast, agreements to negotiate, agreements subject to contract, and partial or inchoate agreements are more problematic insofar as the question of contractual liability is concerned; these agreements will form the main focus of this chapter.

3 2 Certainty

For an agreement to give rise to a contract, it must be sufficiently certain regarding its content and legal consequences.[20] In American law "definiteness" requires that a

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[13] Temkin 1986 *Fordham L Rev* 142.

[14] "Enforcing the Contract to Bargain" (1969) 44 *NYU L Rev* 673 679.

[15] MK Johnson "Enforceability of Precontractual Agreements in Illinois – The Need for a Middle Ground" (1993) 68 *Chi-Kent L Rev* 939 944; Temkin 1986 *Fordham L Rev* 142.

[16] Johnson 1993 *Chi-Kent L Rev* 944-945.

[17] Johnson 1993 *Chi-Kent L Rev* 945; Temkin 1986 *Fordham L Rev* 142.

[18] See ch 2 (2 2 & 2 3).

[19] GC Moss "The Function of Letters of Intent and their Recognition in Modern Legal Systems" in R Schulze (ed) *New Features in Contract Law* (2007) 139 150-156.

[20] LF Van Huyssteen, GF Lubbe & MFB Reinecke *Contract: General Principles* 5 ed (2016) 217; JE Du

contract must provide "the basis for determining the existence of a breach and giving an appropriate remedy".[21] It will be observed that in terms of South African law the validity of pre-contractual agreements of the types described above is considerably limited by this requirement.[22]

In South African contract law, an agreement will be certain if vagueness or incompleteness can be resolved with reference to a mechanism set out in the contract, admissible extrinsic evidence, the naturalia of the agreement or tacit terms.[23] The general test is whether, objectively, the agreement "renders the obligations capable of being enforced by the courts".[24] South Africans courts adopt a liberal approach to contract formation, so as to accord contractual status to agreements that are seriously intended, and courts will not lightly deprive such agreement of legal effect for uncertainty.[25] In *Namibian Minerals Corporation Ltd v Benguela Concessions Ltd*[26] the court explained that "[b]usinessmen are often content to conduct their affairs with only vague or incomplete agreements in hand"[27] and that courts "should strive to uphold – and not destroy – bargains."[28] The same sentiments are expressed in the English case of *Hillas & Co Ltd v Arcos Ltd*.[29] The American author Perillo also warns that courts should not "jump too readily" to the conclusion that an agreement is not a contract due to apparent uncertainty.[30] Courts have nonetheless emphatically stated their unwillingness and inability to displace party autonomy by determining, for the parties,

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Plessis "Possibility and Certainty" in D Hutchison & CJ Pretorius (eds) *Law of Contract in South Africa* 3 ed (2017) 213 218; EA Farnsworth *Contracts* 4 ed (2004) 201; Perillo *Corbin on Contracts* 524-525; E Peel *Treitel on the Law of Contract* 14 ed (2015) 54; M Chen-Wishart "The Agreement" in HG Beale (gen ed) *Chitty on Contracts I: General Principles* 32 ed (2015) 191 290.

[21] *Restatement of Contracts (Second)* sec 33(2); Farnsworth *Contracts* 201.

[22] Van Huyssteen et al *Contract* 70.

[23] R Sharrock *Business Transactions Law* 9 ed (2016) 91; Van Huyssteen et al *Contract* 217; Du Plessis "Possibility and Certainty" in *Law of Contract* 218, 222.

[24] Van Huyssteen et al *Contract* 218.

[25] Van Huyssteen et al *Contract* 218; Sharrock *Business Transactions Law* 90.

[26] 1997 2 SA 548 (A) 561G–I.

[27] *Namibian Minerals Corporation Ltd v Benguela Concessions Ltd* 1997 2 SA 548 (A) 561G–I; see also A Hutchison "Agreements to Agree: Can There Ever be an Enforceable Duty to Negotiate in Good Faith?" (2011) 128 *SALJ* 273 279.

[28] *Namibian Minerals Corporation Ltd v Benguela Concessions Ltd* 1997 2 SA 548 (A) 561G–I.

[29] 1932 147 LT 503 (HL) 514; see also M Chen-Wishart "The Agreement" in *Chitty on Contracts* 290.

[30] *Corbin on Contracts* 136.

the legal content of their agreement.[31]

Writing in the context of English law, Furmston explains that when analysing the enforceability of pre-contractual agreements, the fundamental issue involves establishing the level of uncertainty that will prevent the formation of a contract.[32] In terms of South African, American and English law, the criterion for contract validity is that of reasonable certainty.[33] It must merely be possible to ascertain the parties' intention with reasonable certainty; it is not necessary that an agreement be meticulously precise.[34] The requirement of certainty will now be applied to various pre-contractual agreements identified in the previous chapter.

3 2 1 Agreements imposing limited obligations

Pre-contractual agreements often contain provisions that are intended to impose specific obligations on the parties in the course of negotiations. Confidentiality and exclusivity will be considered as common examples. For these obligations to be contractually enforceable they must be reasonably certain in their content and legal consequences. These types of provisions in pre-contractual agreements are enforceable in civil-law systems, either as part of the final contract or as a contract to negotiate.[35] In common-law systems their enforceability can be more problematic, particularly if the obligations are contained in otherwise non-binding pre-contractual agreements that are not certain and complete.[36] American and English courts have however indicated a willingness to enforce confidentiality and exclusivity provisions included in pre-contractual agreements if parties manifest an intention to be bound.[37]

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[31] Van Huyssteen et al *Contract* 218; J Beatson, AS Burrows & J Cartwright *Anson's Law of Contract* 30 ed (2016) 64; G Klass *Contract Law in the USA* (2010) 123.

[32] Furmston et al *Contract Formation* 230.

[33] Sharrock *Business Transactions Law* 91; Furmston et al *Contract Formation* 230*;* see also the English case of *Scammel & Nephew v Ouston* [1941] 1 AC 251 255; Klass *Contract Law* 123.

[34] Sharrock *Business Transactions Law* 91; M Chen-Wishart "The Agreement" in *Chitty on Contracts* 290; Perillo *Corbin on Contracts* 529-530.

[35] R Lake & U Draetta *Letters of Intent and Other Precontractual Documents: Comparative Analysis of Forms* (1989) 226

[36] Pannebakker *Letter of Intent* 226,229.

[37] Pannebakker *Letter of Intent* 102,118, 138,188-190, 212,215; see also the English case of *JSD Corporation PTE Ltd v Al Waha Capital PJSC Second Waha Lease Ltd* [2009] EWHC 583 (Ch) para 32; and the American cases *Butler v Balolia* (2013) 736 F 3d 609 (1st Cir) 617; *A/S Apothekernes Laboratorium for Specialpraeparater v I.M.C Chemical Group Inc* (1989) 873 F 2d (7th Cir); *JamSports*

Binding provisions are distinguished and enforced separately from the non-binding provisions.[38]

3 2 1 1 Exclusivity

Issues regarding certainty generally relate to the duration of the obligation.[39] In order for an agreement imposing obligations of exclusivity to give rise to a valid contract, the agreement must stipulate the time period for which such obligations must be performed.[40] In *Walford v Miles*[41] the court confirmed the English legal position that an agreement to negotiate exclusively will give rise to a valid contract if it stipulates the time period of exclusivity;[42] in the absence of such time period, the agreement would imply an obligation to negotiate in good faith, which is unenforceable.[43] There has also been American case law that accords with this legal position.[44] Some American courts are however, willing to imply a reasonable duration.[45] Beatson, Burrows and Cartwright criticise the reasoning in *Walford*, and argue that an exclusivity agreement does not imply an obligation to negotiate in good faith, and where there is no stipulated time period the court can impose one based on reasonableness.[46] In English law exclusivity agreements or "lock-out" agreements are sufficiently certain insofar as they impose a negative obligation not to negotiate with other parties; a so-called "lock-in" agreement imposing a positive obligation to negotiate with each other, is too uncertain

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and Entertainment LLC v Paradama Productions (2004) Inc 336 F Supp 2d 824 (N.D III) 846.

[38] Pannebakker *Letter of Intent* 118, 138-139, 190, 213, 215.

[39] 215.

[40] N Andrews *Contract Law* 2 ed (2015) 31-32; M Chen-Wishart "The Agreement" in *Chitty on Contracts* 333; Beatson et al *Anson's Law of Contract* 70; M Fontaine & F De Ly *Drafting International Contracts: An Analysis of Contract Clauses* (2009) 26; EA Farnsworth "Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 *Colum LR* 217 279-280; VS Foreman "Non-Binding Preliminary Agreements: The Duty to Negotiate in Good faith and the Award of Expectation Damages" (2014) 72 *U Toronto Fac L Rev* 12 30.

[41] [1992] 2 AC 128 140D.

[42] See also *Pitt v PHH Asset Management Ltd* [1994] 1 WLR 327 CA para 18,21-23.

[43] *Walford v Miles* [1992] 2 AC 128 140.

[44] *American Broadcasting Companies Inc v Warner Wolf* (1981) 52 NY (2nd Cir) 394 399-401.

[45] Pannebakker *Letter of Intent* 189, 215; *Channel Home Centers, Div. of Grace Retail Corp. Grossman* (1986) 795 F.2d 291, (3d Cir) 301.

[46] *Anson's Law of Contract* 70.

to be enforceable.[47]

There does not appear to be South African case law on the validity of an obligation to negotiate exclusively. From comparative observations it is possible to propose that should such an agreement come before a South African court it should be enforceable if the duration of exclusivity has expressly been provided or a reasonable duration can be inferred based on the nature and complexity of the transaction.

3 2 1 2 Confidentiality

Confidentiality agreements are concluded in various contractual and pre-contractual contexts including between employer and employee,[48] in national transactions such as mergers and acquisitions, and in international commercial negotiations.[49] Confidentiality agreements will have a number of common provisions irrespective of whether they apply to employees or to parties to commercial transactions.[50] Confidentiality agreements, like restraint of trade agreements, will be carefully analysed by courts, particularly in the context of employment relationships. This analysis will be much narrower in the context of commercial negotiations.[51]

Confidentiality clauses must be carefully drafted to avoid unenforceability.[52] This is vital because an invalid confidentiality agreement can cause the subject matter of such agreement to lose its "confidential status".[53] Dadpey, an American author, explains that the validity of confidentiality agreements will depend on the "language of its specific terms".[54] In the American legal system and the European legal systems

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[47] J Cartwright *Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer* (2016) 88-89.

[48] GM Lawrence & C Baranowski *Representing High-Tech Companies* (2005) § 3.01.

[49] U Babusiaux "Art 2:302: Breach of Confidentiality" in N Jansen & R Zimmermann (eds) *Commentaries on European Contract Laws* (2018) 378; Lawrence & Baranowski *Representing High-Tech Companies* § 3.01; M Fontaine "Confidentiality Agreements in International Contracts" 1991 *Int'l Bus LJ* 5 8-10.

[50] Lawrence & Baranowski *Representing High-Tech Companies* § 3.04[1].

[51] EA Rowe & SK Sandeen *Trade Secrecy and International Transactions: Law and Practice* (2015) 70.

[52] See N Dadpey "Issues Enforcing Nondisclosure Agreements" (07-04-2017) *ACC* <https://www.acc.com/legalresources/quickcounsel/issues-enforcing-nondisclosure-agreements.cfm?makepdf=1 > (accessed 19-12-2018).

[53] Dadpey "Issues Enforcing Nondisclosure Agreements" *ACC*; see also Lawrence & Baranowski *Representing High-Tech Companies* § 3.01.

[54] "Issues Enforcing Nondisclosure Agreements" *ACC*.

studied by the Working Group on International Contracts,[55] confidentiality agreements generally contain standard provisions such as a clause defining the subject matter covered by the confidentiality agreement, the obligations of the party receiving confidential information, the restriction on use, the duration of such obligation, and the sanctions for breach.[56]

In America, issues regarding enforceability generally concern the definition of confidential information, the duration of confidentiality and the geographic application of the agreement.[57] A confidentiality agreement must be reasonable, that is to say that it should not be too broad in its formulation and the terms should not be vague or ambiguous.[58] Otherwise the confidentiality agreement may be void for uncertainty or for being too restrictive. If the definition of confidential information is formulated too broadly, particularly in the context of employment confidentiality agreements, it may also be unenforceable.[59] Some American courts require confidentiality agreements to have reasonable time and reasonable geographic limitations to be enforceable.[60] In both English and American legal systems it is also possible for confidentiality obligations to persist after the termination of negotiations or contract conclusion.[61]

In South Africa, confidentiality provisions are commonly included or implied into restraint of trade of agreements. In *Traka Afrika (Pty) Ltd v Amaya Industries*[62] the court explained that "[a]greements in restraint of trade, and by implication confidentiality agreements, voluntarily entered into pursuant to one's right to freedom

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[55] See Fontaine & De Ly *Drafting International Contracts* 239,278.

[56] Fontaine & De Ly *Drafting International Contracts* 239,278; Dadpey "Issues Enforcing Nondisclosure Agreements" *ACC*; Babusiaux "Art 2:302: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 378; Fontaine 1991 *Int'l Bus LJ* 13-14,62-63.

[57] Lawrence & Baranowski *Representing High-Tech Companies* § 3.03[1].

[58] Dadpey "Issues Enforcing Nondisclosure Agreements" *ACC*; Lawrence & Baranowski *Representing High-Tech Companies* § 3.03[1]; see American case of *Trailer Leasing Co a divison of Keller Systems Inc v Associated Rental Systems Inc* (1996) US Dist Lexis 9654 para 17-19 where the court concluded that the confidentiality clause was unenforceable because it was vague and overbroad because it sought to protect all information and not only that which was confidential. It also had no geographical limitations.

[59] Lawrence & Baranowski *Representing High-Tech Companies* § 3.03[1].

[60] See § 3.03[3] and fn 14 thereto.

[61] 233, 238, 280.

[62] [2016] ZAGPJHC 24 para 45.

of contract, are … valid and enforceable" as long as they are not unreasonable.[63] Although there does not appear to be South African case law specifically dealing with the certainty requirement in the context of confidentiality agreements, the general principles of the South African law of contract dictate that agreements should be sufficiently certain and thus not be vague or ambiguous. It is therefore argued that as in American law, South African law will also require that the definition of confidential information not be formulated over broadly, and that the time periods and geographic application be clearly stipulated so that the agreement is sufficiently certain to be enforced.

3 2 2 Agreements to negotiate

The enforceability of agreements to negotiate are generally determined with reference to the principles regulating certainty.[64] As mentioned in chapter 2, there are different types of agreements to negotiate. Negotiation clauses can for example be included in pre-existing contracts,[65] intended to be binding irrespective of the outcome of negotiations[66] thus, an agreement of lease could contain a negotiation agreement on changes in the rental. Secondly, otherwise non-binding pre-contractual agreements could outline the term(s) of the envisaged contract.[67] And thirdly, parties could conclude agreements that do not purport to outline the terms of the envisaged contract, but solely indicate an arrangement to negotiate the principal contract.[68] The latter two types of agreements to negotiate can be described as "independent"[69] or "bare" agreements to negotiate, because they do not form part of an existing contract

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[63] See para 46-49 for the test to determine whether the restraint is reasonable and thus not contrary to public policy.

[64] M Furmston & GJ Tolhurst *Contract Formation: Law and Practice* 2 ed (2016) 316-317.

[65] LE Trakman and K Sharma "The Binding Force of Agreements to Negotiate in Good Faith" (2014) 73 *CLJ* 598 617-619; Furmston & Tolhurst *Contract Formation* 316-317; H Hoskins "Contractual Obligations to Negotiate in Good Faith: Faithfulness to the Agreed Common Purpose" (2014) 130 *LQR* 131 131.

[66] Hoskins 2014 *LQR* 131.

[67] Trakman & Sharma 2014 *CLJ* 604; Hoskins 2014 *LQR* 131; *Teachers Insurance v Tribune* Co (1987) 670 F Supp 491 (S D N Y) 499.

[68] Perillo *Corbin on Contracts* 142; Hoskins 2014 *LQR* 131.

[69] Trakman & Sharma 2014 *CLJ* 604.

and are concluded prior to the main contract that the parties intend to negotiate.[70] Independent agreements to negotiate will not bind the parties to conclude the final contract, but merely impose an obligation to negotiate in good faith.[71]

Contractual obligations to negotiate must be distinguished from a legal duty to negotiate in good faith, imposed ex lege.[72] We already noted in chapter 2 that the scope of this thesis will be limited to the obligation to negotiate in good faith arising in contract. In this regard, a contract may contain an express obligation to negotiate "in good faith" or simply contain an obligation to negotiate. Whether such an express reference to good faith is necessary in terms of South African law is questionable, "since it could hardly be intended that negotiations be conducted in any other manner".[73] Whether the nature of the agreement to negotiate and express reference to good faith has an impact on validity will be examined with reference to the legal position in South Africa, England, America and Germany.

3 2 2 1 Foreign law

(i) English law

As a general point of departure, English law recognises that an agreement to negotiate is enforceable if there is a deadlock-breaking mechanism rendering the obligation sufficiently certain.[74] In *Cable & Wireless Plc v IBM United Kingdom Ltd*[75] the court had to consider the validity of a clause that required parties to negotiate in good faith to resolve any disputes in relation to their agreement, failing which their dispute was to be resolved through an alternative dispute resolution ("ADR") procedure. The court found that the clause was enforceable because it went further than merely imposing an obligation to negotiate but actually prescribed the steps to taken by the parties which included the ADR procedure. The latter procedure was sufficiently certain for a court to evaluate whether parties have complied.

In absence of such ADR clauses, the English common-law traditionally regards

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[70] 604.

[71] Hoskins 2014 *LQR* 131. This is also referred to as a type II preliminary agreement in American law – see *Teachers Insurance v Tribune* Co (1987) 670 F Supp 491 (S D N Y) 499.

[72] Hoskins 2014 130 *LQR* 131.

[73] Du Plessis "Certainty and Possibility" in *Law of Contract* 220.

[74] *Cable & Wireless Plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm).

[75] [2002] EWHC 2059 (Comm).

agreements to negotiate as invalid and unenforceable.[76] Courts generally tend to conclude that such agreements are uncertain in content and contrary to public policy because they bind parties to obligations that could not be intended to be legally binding.[77] These agreements are unenforceable primarily due the difficulties involved in identifying the appropriate criteria to give content to the obligation to negotiate.[78] According to Trakman and Sharma the reference to good faith does little to render agreements to negotiate certain or at least ascertainable; in fact, it often contributes to uncertainty because it is difficult to determine the standard of conduct required by such an obligation.[79] However, on further investigation, it becomes apparent that reference to good faith may in fact be useful in giving content to an obligation to negotiate.

To understand the current law, it may be beneficial to consider the history of negotiation clauses in England and the courts' rationale for the traditional legal position. An early and famous case dealing with the enforceability of negotiation clauses is *Hillas & Co Ltd v Arcos Ltd.*[80] In this case Lord Wright recognised that according to the traditional theory of contract formation an agreement to negotiate can give rise to an enforceable contract if consideration is given.[81] Lord Wright explained that "there is then no bargain except to negotiate"[82] and that negotiations may come to an end without the final contract being concluded.[83]

However, Lord Denning in *Courtney & Fairbairn Ltd v Tolani Brothers (Hotels Ltd)*[84] rejected the views of Lord Wright and concluded that an agreement to negotiate is too uncertain to give rise to a contract. He stated as follows:

> "If the law does not recognise a contract to enter into a contract (when there is a fundamental term yet to be agreed) it seems to me it cannot recognise a contract to

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[76] Chen-Wishart "The Agreement" in *Chitty on Contracts* 286; Beatson et al *Anson's Law of Contract* 68-69; Peel *Law of Contract* 66-67.

[77] Trakman & Sharma 2014 *CLJ* 599; Hoskins 2014 *LQR* 131.

[78] Trakman & Sharma 2014 *CLJ* 610.

[79] Trakman & Sharma 2014 *CLJ* 599; see also *Walford v Miles* [1992] 2 AC 128 135 where the court explained that implying an obligation of good faith into the agreement would not render it certain.

[80] 1932 147 LT 503 (HL).

[81] 515.

[82] 515.

[83] 515.

[84] [1975] 1 WLR 297 301.

> negotiate. The reason is because it is too uncertain to have any binding force. No court could estimate damages because no one could tell whether negotiations would be successful or fall through: or if successful what the result would be."[85]

He concluded that for this reason that agreements to negotiate, like agreements to enter into an agreement, are unknown to English law.

In a further seminal case, *Walford v Miles*[86] ("*Walford*") the House of Lords preferred the view of Lord Denning. In this case the parties concluded an oral agreement, subject to contract, for the sale of a business. The parties also agreed that Mr and Mrs Miles would negotiate exclusively with the Walfords if they obtained a comfort letter from the bank confirming the bank's willingness to fund the envisaged purchase. Mr and Mrs Miles nevertheless negotiated with and sold the business to a third party.

In this case the parties had not expressly agreed to negotiate in good faith. The agreement in question was a lock-out agreement, which was found to be unenforceable because it failed to stipulate the time period of exclusivity.[87] The Walfords argued that the lock-out agreement was "unworkable", unless it was interpreted as imposing an implied obligation to negotiate in good faith.

Lord Ackner found that a lock-out agreement need not impose a positive obligation to negotiate to be effective as its utility lay in imposing a negative obligation not to negotiate with third parties.[88] However, he took the matter further by explaining that the main reason such a term could not be implied was because agreements to negotiate, like agreements to agree, are unenforceable because they are inherently uncertain.[89] Uncertainty in this regard relates to the content of the obligation to negotiate in good faith. Lord Ackner posed two main questions that describe the nature of this uncertainty:

> "[H]ow is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an 'agreement'?" [90]

On this basis, Lord Ackner concluded that a bare obligation to negotiate in good faith

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[85] 301-302.

[86] [1992] 2 AC 128 135.

[87] 140D.

[88] 139 G-H.

[89] 138.

[90] 138.

is without legal content.[91]

However, the current legal position may not be quite as clear cut as it seems and needs to be examined in light of developments regarding the obligation to perform contracts in good faith, the obligation to negotiate tender contracts in good faith and negotiation obligations arising from pre-existing contracts. This will be followed by suggestions regarding future legal development so as to enforce independent agreements to negotiate in good faith.

(a) Obligation of good faith in the context of performance and collateral tender agreements

The uncertainty of the obligation to negotiate in good faith needs to be considered in light of the approach to uncertainty in general[92] and the progression in case law towards attaching a legal meaning to good faith in specific practical contexts.[93] Particularly important developments have taken place in the context of good faith performance obligations and tendering agreements.[94] Chen explains that while good faith has been regarded as an "elusive concept", recent case law in these areas has provided useful clarification.[95]

In the two decades since the *Walford* decision, which dismissed the concept of good faith as inherently uncertain, English law has seen some development. For example, English courts have encountered little difficulty in recognising and legally defining the obligation to perform or act in good faith.[96] Courts have even been willing to imply such an obligation where one party is given the power in terms of a contract to affect the

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[91] 138E-G.

[92] See Hoskins 2014 *LQR* 141-142. Courts try to resolve uncertainty by taking into account the context and purpose of the agreement when interpreting its terms (a contextual approach). Hoskins argues that the blanket unenforceability of an obligation to negotiate in good faith is inconsistent with such an approach.

[93] Hoskins 2014 *LQR*

[94] Chen 2017 *BLR* 19; Hoskins 2014 *LQR* 140,142-143.

[95] J Chen "Should English Contract Law Adopt a General Duty to Negotiate in Good Faith" (2017) 4 *BLR* 18 19.

[96] G Leggatt "Negotiations in Good Faith: Adapting to Changing Circumstances in Contracts and English Contract Law" (19-10-2018) *Jill Poole Memorial Lecture at Aston University* <https://www.judiciary.uk/wp-content/uploads/2018/10/leggatt-jill-poole-memorial-lecture-2018.pdf> (accessed 12-12-2019) 14.

interests of the other party.[97] Chen argues that courts will be able, in similar manner, to give content to the obligation to negotiate in good faith.[98] In fact, an obligation to perform a contract in good faith can sometimes even require parties to negotiate in good faith.[99] This development challenges the principles enunciated in the *Walford* decision and its authority for the unenforceability of agreements to negotiate in present-day English law.

Further support for the conclusion that good faith obligations can be defined with sufficient certainty is found in cases involving collateral contracts entered into in the course of tender procedures.[100] These contracts regulate contract formation by imposing standards of "good faith and fairness".[101] There is uncertainty regarding whether this obligation is imposed by law or is contractual in nature,[102] but irrespective of the source of such obligation, its enforcement in this context can be instructive in how certainty can be imparted to a contractual obligation to negotiate.

Hoskins argues that the judicial approach to good faith performance clauses and collateral tendering contracts illustrates how uncertainty regarding the content of a good faith obligation can be resolved by accepting that good faith entails "faithfulness to an agreed common purpose" and by adopting a contextual, purposive approach to determine the content of such obligation.[103] He concludes that courts can adopt this approach to enforce negotiation obligations in circumstances where the agreement, interpreted in light of the specific context, manifests a clear common purpose comprising of a "sufficiently certain framework for negotiation." [104] Defining the scope of the obligation allows courts to "police" whether there has been compliance

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[97] 14.

[98] Chen 2017 *BLR* 19.

[99] Chen 2017 *BLR* 20 provides as an example the case of *Gold Group Properties Ltd v BDW Trading Ltd* [2010] EWHC 1632 (TCC) paras 3,4,13,88. This case dealt with a clause for the renegotiation of price and an obligation to act in good faith. One of the issues raised was whether there had been breach of the obligation to act in good faith due to a failure to renegotiate the price.

[100] Hoskins 2014 *LQR* 148.

[101] Hoskins 2014 LQR 147-148; see *Blackpool and Fylde Aero Club v Blackpool Borough Council* [1990] 1 WLR 1195 1204 and *Fairclough Building Ltd v Port Talbot Borough Council* (1992) 62 BLR 82.

[102] Hoskins 2014 *LQR* 147-148.

[103] 2014 *LQR* 150-151.

[104] 152.

(addressing concerns raised in *Walford*).[105]

(b) Negotiation clauses in pre-existing contracts

It also appears that English courts may be willing to recognise obligations to negotiate in good faith arising from pre-existing contracts.[106] Lord Ackner in the *Walford* case, concluded that a "bare agreement to negotiate is without legal content."[107] It can be argued that this formulation by implication allows or does not preclude negotiation clauses in pre-existing contracts. [108] This distinction enables courts to recognise the validity of the latter contracts.[109] A pre-existing contract generally provides an "objective framework" to give content to the negotiation obligation, limit its scope, and allow courts to enforce it.[110] Two recent cases illustrate this.

In *Petromec Inc v Petroleo Brasileiro SA Petrobras*[111] ("*Petromec*") the negotiation clause was express and formed part of a complex contract. The court explained that *Walford* was distinguishable because in that case there was no pre-existing contract (the agreement was subject to contract).[112] In the present case, the negotiation clause required parties to negotiate in good faith about the reasonable costs of extra work to be done pursuant to the alteration of specifications in the initial contract. Establishing whether there was bad faith in negotiations may be difficult, but is not impossible. If the parties' negotiations were unsuccessful, the court could ascertain such "reasonable costs" for the parties.[113] The scope of the obligation was sufficiently limited, and the agreement included objective criteria that could be applied by the court.[114] The court, based on these distinctions, recognised the enforceability of an obligation to negotiate in good faith.[115]

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[105] 151.

[106] Trakman & Sharma 2014 *CLJ* 617-619; Chen 2017 *BLR* 20; Hoskins 2014 *LQR* 152; *Butters v BBC Worldwide Ltd* [2009] EWHC 1954 (Ch) para 148,151.

[107] [1992] 2 AC 128 138.

[108] Chen 2017 *BLR* 20; Hoskins 2014 *LQR* 131.

[109] Chen 2017 *BLR* 20.

[110] Chen 2017 *BLR* 20; Hoskins 2014 *LQR* 153,157.

[111] [2005] EWCA Civ 891 paras 120-121.

[112] Para 120.

[113] Paras 117-119.

[114] [2005] EWCA Civ 891 paras 117-118.

[115] Para 121.

In *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd*[116] *("Emirates")* the court had to decide on the enforceability of a clause in a contract that required parties "to resolve the dispute or claim by friendly discussion" before proceeding to arbitration. The contract in question did not require the negotiation of outstanding terms; the issue rather concerned the enforceability of an agreement to negotiate claims or disputes.[117] Teare J considered various cases and reached the conclusion that there was no binding authority that required him to conclude that such an obligation is unenforceable.[118] An obligation in a pre-existing contract to endeavour to resolve disputes "by friendly discussions in good faith and within a limited period of time" is enforceable.[119] Teare J explained that this obligation was sufficiently certain because it imposed recognisable standards of fairness, honesty and sincerity in the discussion of disputes.[120]

The recognition that an obligation to negotiate in good faith in a pre-existing contract is enforceable has important implications despite the existence of a deadlock-breaking mechanism. The effect of enforceability of a negotiation clause is that parties will first have to comply with the obligation to negotiate before invoking the arbitration clause. Chen suggests that the two above mentioned cases demonstrate the viability of imposing such an obligation even though they do not explicitly recognise independent agreements to negotiate.[121]

(c) Independent agreements to negotiate

While English academics such as Peel appear to support the outcome of the *Walford* decision,[122] it has received considerable criticism from other English academics and in some common-law quarters.[123] The New South Wales case of *United Group Rail*

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[116] [2014] EWHC 2104 (Comm) para 3.

[117] Paras 41, 64.

[118] Paras 61, 63.

[119] Paras 52, 63-64.

[120] Para 64.

[121] Chen 2017 *BLR* 21.

[122] *The Law of Contract* 63-67.

[123] Bradgate "Formation of Contract" in *Law of Contract* 455; see Chen 2017 *BLR* 18-21; Hoskins 2014 *LQR* 157; A Berg "Promises to Negotiate in Good Faith" 119 *LQR* 357-420; J Steyn "Contract Law: Fulfilling the Reasonable Expectation of Honest Men" (1997) 113 *LQR* 438-439.

Services Limited v Rail Corporation New South Wales[124] which, as we will see, so strongly influenced the judgement of Blignault J in the *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd* case,[125] serves as an example. Here the court found *Walford* unpersuasive, insofar as it establishes "sweeping generalised rules" of unenforceability that are unsustainable and of little practical value in the commercial context.[126]. The court emphasises that it is possible for negotiation obligations to have a legal content.[127] Contractual negotiations are generally a "self interested commercial activity." Given this context, it is possible to conclude that an obligation to negotiate in good faith requires honesty, seriousness and genuineness.[128]

Rejecting generalised rules allows courts to give effect to freedom of contract and to decide each individual case on its own merits.[129] It is for example possible that an independent agreement to negotiate will be sufficiently certain if the parties provide a detailed framework for negotiations.[130] Beatson, Burrow and Cartwright argue that Lord Ackner's reasoning in *Walford* is problematic, because it does not give effect to the "reasonable expectations of business people" and "appears to require a higher degree of certainty and less willingness to use the standards of reasonableness to resolve ambiguity."[131] They also express disappointment that the *Hillas* case, which recognised agreements to negotiate, was rejected.[132]

In *Petromec*[133] Longmore LJ cautioned against courts establishing a "blanket unenforceability" of agreements to negotiate. In this regard the following statement was made:

> "It would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered. …To decide that it has no 'legal content' to use Lord Ackner's phrase would be for the law deliberately to defeat the reasonable expectations of

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[124] 2009 NSWCA 177 para 65.

[125] See ch 3 (3 2 2 2).

[126] Paras 65-66.

[127] Paras 65-66.

[128] Para 71.

[129] Chen 2017 *BLR* 21.

[130] Hoskins 2014 *LQR* 157, Chen 2017 *BLR* 21.

[131] *Law of Contract* 69.

[132] 70.

[133] [2005] EWCA Civ 891 para 119.

honest men..."[134]

This obiter statement suggested that courts may be willing to develop the law on agreements to negotiate further. However, in the subsequent case of *Barbudev v Eurocom Cable Management Bulgaria Eood*[135], the court refused to enforce an obligation in a side letter that required parties to negotiate the principal contract in good faith. In *Charles Shaker v Vistajet Group Holding SA*,[136] Teare J stressed that *Petromec* was an exception to the general rule and did not set a precedent for the enforceability of all obligations to negotiate in good faith. Unlike *Petromec*, the agreement in this case contained no objective criteria for courts to assess the terms of the principal contract and the obligation was therefore unenforceable.[137] A negotiation clause will not render an otherwise enforceable agreement unenforceable, but the negotiation clause is not of itself enforceable. Such a clause may be enforceable where parties have provided, "objective criteria, or machinery for resolving any disagreement".[138]

It appears that English law does not distinguish between agreements to agree and agreements to negotiate, and that it determines the enforceability of an obligation to negotiate in good faith with reference to whether the outstanding terms of the envisaged transaction can be determined.[139] Leggatt explains that the analogy to an agreement to agree is a bad one – "parties who agree to negotiate do not agree to agree".[140] Rather they are agreeing to a process of negotiations with view to reaching a final agreement.[141]

In *Donwin Productions v EMI films Ltd*[142] the court was willing to imply an obligation to negotiate in good faith into a contract with minor outstanding terms. There is no full report for this case, but Hoskins provides an interesting analysis.[143] He explains that

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[134] Para 121.

[135] [2011] EWHC 1560 (Comm) paras 97,103.

[136] [2012] EWHC 1329 (Comm) para 17.

[137] Para 17.

[138] Para 97.

[139] See *Barbudev v Eurocom Cable Management Bulgaria Eood* [2011] EWHC 1560 (Comm) para 97.

[140] "Negotiations in Good Faith" *Jill Poole Memorial Lecture at Aston University* 9.

[141] 9.

[142] [1984] QBD the Times, March 9.

[143] 2014 *LQR* 154.

in contrast with the *Petromec* case, there was no objective framework that courts could use to determine outstanding terms if negotiations were unsuccessful.[144] It appears that the parties did not intend for the court to perform this function[145]. He argues that this does not necessarily render the negotiation clause uncertain. The agreement may still contain a "framework for negotiations" (which does not "dictate any single outcome")[146] that courts may apply to evaluate whether parties have complied with their obligations.[147] Such a framework can include "negotiating agenda" or set out the requisite steps that must be complied with during negotiations.[148]

Hoskins concludes that the certainty of a negotiation clause should not be determined by whether a court has been equipped with a means (perhaps a deadlock-breaking mechanism) to determine outstanding terms if negotiations fail, but rather whether the negotiation obligation interpreted in the context of the wider agreement is so vague that it gives a broad discretion to the parties which courts are incapable of policing.[149] Leggatt argues that "it is not reason to hold a clause void for uncertainty that the parties have chosen to express the clause in broad evaluative language".[150] In fact, judges are often called upon to determine what such standards require in a particular case. [151]

English courts nevertheless remain extremely conservative in their approach to the enforceability of express agreements to negotiate and consequently will seldom be willing to imply an obligation to negotiate in good faith into an agreement.[152]

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[144] 154

[145] 154.

[146] 154

[147] 154.

[148] Chen 2017 *BLR* 21; Trakman & Sharma 2014 *CLJ* 621.

[149] Hoskins *LQR* 154.

[150] "Negotiations in Good Faith" *Jill Poole Memorial Lecture at Aston University* 6.

[151] 6.

[152] Hoskins *LQR* 137,140; C Perry "Good Faith in English and US Contract Law: Divergent Theories, Practical Similarities" (2016) 17 *BLI* 27 36; *Mallozzi v Carapelli* [1976] Lloyd's Rep 407 414. Note however the case of *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB) where the court was willing to imply an obligation of good faith into a relational contract; see also *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd* [2014] EWHC 2104 (Comm) para 51, where the court concluded that "friendly discussions" imported an obligation to negotiate in good faith.

In conclusion, Leggatt J in *Astor Management AG v Atalaya Mining Plc*[153] validly points out that:

> "The role of the court in a commercial dispute is to give legal effect to what the parties have agreed, not to throw its hands in the air and refuse to do so because the parties have not made its task easy".

If commercial law and courts are to properly perform their function, English contract law will have to be sufficiently flexible to give legal meaning to obligations to negotiate, which will likely become more common in the future.[154] That English law may require development to meet modern commercial needs is bolstered by the fact that, as we will presently see, their approach is not uniformly adopted in the common-law tradition.

(ii) American law

The investigation of American law on agreements to negotiate, which is far more developed than other common-law counterparts, will be conducted in three parts. First the traditional legal position will be set out. This will be followed by a brief examination of the suggestions put forward by American academics. Lastly, developments in American case law will be analysed.

American courts traditionally refused to recognise agreements to negotiate as valid contracts due to concerns over uncertainty.[155] Whether the agreement referred to an obligation to negotiate in "good faith" did not affect this legal position.[156] There is American case law that accords with the English law position that independent agreements to negotiate are unenforceable.[157] In *Candid Products v International Skating Union*,[158] the claimants argued that the court could render the obligation to negotiate in good faith certain by implying specific duties.[159] The court rejected this argument on the basis that it would require the court to "make a contract for the parties

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[153] [2017] EWHC 425 (Comm) para 64.

[154] Leggatt "Negotiations in Good Faith" *Jill Poole Memorial Lecture at Aston University* 23.

[155] Perillo *Corbin on Contracts* 142.

[156] JCC Sanders "Looking for Faith in All the Wrong Places: Rethinking Agreements to Negotiate in Good Faith" (2006) 7 *UC Davis Bus LJ* 199 213.

[157] Furmston & Tolhurst *Contract Formation* 322.

[158] 1982 530 F Supp 1330 (S D N Y) 1333.

[159] 1335.

rather than enforce any bargain that the parties may themselves have reached." [160]

American academics developed various theories regarding the enforceability of agreements to negotiate.[161] Farnsworth argues that in the "intermediate regime" (between negotiation and principal contract formation) there are two types of enforceable pre-contractual agreements, namely agreements with open terms and agreements to negotiate, and that both impose an obligation to negotiate in good faith.[162] Agreements with open terms record most of the terms of the envisaged contract and, in contrast with agreements to negotiate, bind parties to the principal contract irrespective of the outcome of negotiations.[163] If parties fail to negotiate in good faith, a court may conclude that the original agreement is binding and fill in outstanding terms.[164] The category the agreement falls into depends upon the intention of the parties.[165]

Burton and Andersen suggest that there are various contractual duties that can be imposed by agreements to negotiate.[166] Such agreements can impose "procedural duties" or a specific standard of behaviour in the course of negotiations.[167] They can also commit parties to certain terms exclusively for purposes of negotiation (meaning that the terms are non-binding) or bind parties to the final contract, irrespective of the outcome of negotiations.[168]

Sanders criticises the enforcement of agreements with open terms, explaining that they are difficult to distinguish from agreements to negotiate and are indistinguishable from unenforceable agreements to agree.[169] He argues in favour of the recognition of a "good faith reliance contract" that does not bind parties to conclude the final contract, but requires parties to refrain from bad faith conduct in the course of negotiations.[170]

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[160] 1335.

[161] Knapp 1969 *NYU L Rev* 673 674; Sanders 2006 *UC Davis Bus LJ* 208.

[162] Farnsworth 1987 *Colum LR* 253,263; NE Nedzel "A Comparative Study of Good Faith, Fair Dealing and Precontractual Liability" (1997) 12 *Tul Eur & Civ LF* 97 119.

[163] Farnsworth 1987 *Colum LR* 249-253; see also 3 2 3.

[164] Nedzel 1997 *Tul Eur & Civ LF* 119.

[165] Farnsworth 1987 *Colum LR* 253.

[166] *Contractual Good Faith: Formation, Performance, Breach, Enforcement* (1995) 334.

[167] 334.

[168] 334.

[169] 2006 *UC Davis Bus LJ* 210.

[170] 228-229.

These scholarly suggestions enjoy various levels of support in different American states. Some courts, while recognising the distinction between pre-contractual agreements and ultimate contracts, are unwilling to enforce agreements in the "intermediary stage".[171] It will be observed that courts in Delaware, New York, California, Illinois and Washington, DC are more inclined to enforce agreements to negotiate in good faith.[172] By contrast, courts in Virginia[173] and Texas[174] are generally unwilling to enforce these agreements.

(a) Development of the law to enforce certain agreements to negotiate

In *Itek Corporation v Chicago Aerial Industries,*[175] the court concluded that a negotiation clause in a letter of intent that required the parties to make every "reasonable effort" to agree upon and conclude the envisaged contract could be enforceable.[176] The court explained that parties were obliged to negotiate in good faith in an attempt to reach a final agreement. This paved the way for the recognition of good faith negotiation obligations in pre-contractual agreements.[177]

In *Siga Technologies Inc v PharmAthene Inc*[178] the court reaffirmed the contractual enforceability of an express obligation to negotiate in good faith. In this case the parties had concluded a license term sheet and a merger term sheet which left some terms for future negotiation.[179] In both the merger term sheet and a separate bridge loan agreement the parties agreed to negotiate the outstanding terms of the license term sheet in good faith.[180] The court concluded that such an obligation is enforceable. [181] There were a number of significant factors that favoured such a conclusion. The term

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[171] Pannebakker *Letter of Intent* 163; *Venture Associates Corporation v Zenith Data Systems Corp* (1996) 96F 3d 275 (7th Cir).

[172] Pannebakker *Letter of Intent* 162.

[173] *Virginia Power Energy Marketing v EQT Marketing LLC* (2012) 88 (E.D Va.)

[174] *Radford v. McNehy* 104 S W 2d 472 (Tex 1937) 474-475*; Maranatha Temple Inc v Enter Prods CO* (1994) 893 SW 2d 92 (Tex App) 103-104.

[175] (1968) 248 A 2d 625 (Del).

[176] 627-628, 629.

[177] Perillo *Corbin on Contracts* 143.

[178] (2013) 67 A 3d 330 (Del) 344-345.

[179] 336.

[180] 336-338.

[181] 344, 346.

sheet set out the time period for negotiation.[182] Both term sheets contained an express obligation to negotiate in good faith. The court emphasised the "express contractual language" of the obligation to negotiate in good faith.[183] It was also significant that the preliminary agreement was relatively comprehensive and contained some material terms.[184] It will be seen that this will also influence the remedy available.[185]

In *Copeland v Baskin Robbins USA*[186] the court also enforced an obligation to negotiate in good faith in a pre-contractual agreement and distinguished agreements to negotiate from unenforceable agreements to agree.[187] Obligations will have been discharged if parties have negotiated in good faith, even though there is no obligation to conclude the final contract.[188] The court dismissed the proposition that such an obligation is uncertain, explaining that "ordinary citizens applying their experience and common sense are well equipped to determine whether the parties negotiated with each other in good faith".[189]

It is clear that parties can potentially conclude letters of intent or other pre-contractual agreements which impose an express contractual obligation to negotiate in good faith.[190] Whether such an obligation can be implied is a more complex matter. Courts in states that are willing to recognise the intermediary stage are not in agreement regarding an implied obligation to negotiate in good faith.[191] Some courts will only enforce such an obligation in an otherwise non-binding pre-contractual agreement if parties have expressly manifested an intention to be bound by such obligation.[192] Other courts accept that an obligation to negotiate in good faith may be implied where the facts are strong enough to support it.[193] Some states thus recognise

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[182] 338.

[183] 344, 346.

[184] 346.

[185] See ch 4.

[186] 117 Cal Rptr 2d 875 (Cal.ct App 2002) 878.

[187] 880.

[188] 880.

[189] 884.

[190] *Vestar Dev II v General Dynamics Corp* (2001) 249 F 3d 958 (9th Cir) 961.

[191] Pannebakker *Letter of Intent* 163.

[192] 163.

[193] Pannebakker *Letter of Intent* 163; BA Blum *Examples and Explanations of Contracts* (2017) para 10 6 4; See *Brown v Cara* (2005) 420 F 3d 148 (2nd Cir).

that a pre-contractual agreement "as such gives rise to an obligation to negotiate the ultimate agreement in good faith", even if the pre-contractual agreement is otherwise non-binding.[194] These respective legal positions are illustrated by cases such as *Channel Home Centers, Div of Grace Retail Corp v Grossman*[195], which dealt with a letter of intent that outlined the most important terms of a lease and imposed an obligation of exclusivity. The court concluded that the letter of intent and surrounding circumstances indicated that the parties intended to be bound by an obligation to negotiate in good faith, which was sufficiently certain, because the agreement set out the steps required to comply with such obligation.

Cases like these are significant because they essentially alter the traditional rules of contract law that agreements to agree and by implication agreements to negotiate in good faith are unenforceable.[196] Furthermore, courts have departed from the traditional all or nothing approach to contract formation by recognising that pre-contractual agreements can give rise to intermediate obligations.[197]

There is still a presumption that pre-contractual agreements are not intended to be binding in respect of the final contract, but a new rule appears to have been developed by precedent that parties are obliged to negotiate regarding outstanding terms with a view to reaching a final contract.[198] The courts in some of these cases specifically chose to paraphrase the obligation as one to negotiate in good faith rather than to use the literal wording of the parties which may simply have been to agree to negotiate. This could be because of the rule that all contracts must be performed in good faith. Alternatively, it can be argued that the only way to make sense of an obligation to negotiate is to interpret it as imposing an obligation to negotiate in good faith.[199]

In *Teachers Insurance & Annuity Association of America v Tribune CO*[200] ("*Tribune Co*"), Judge Leval gave a comprehensive analysis of the obligation to negotiate in good faith and departed from prior precedent by implying such an obligation into a

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[194] Pannebakker *Letter of Intent* 163.

[195] 1968 795 F 2d 291 (3rd Cir) 300.

[196] MA Eisenberg *Foundational Principles of Contract Law* (2018) 507.

[197] A Schwartz & RE Scott "Precontractual Liability and Preliminary Agreements" (2007) 120 *Harv L Rev* 661 675.

[198] 675.

[199] Eisenberg *Principles of Contract Law* 507.

[200] (1987) 670 F Supp 491 (S D N Y) 494.

preliminary agreement. This seminal case completely altered the way in which American law deals with agreements to agree and incomplete agreements.[201] The court recognised two types of enforceable preliminary agreements. Type I preliminary agreements are complete agreements, but parties merely desire the conclusion of a formal contract that memorialises their agreement.[202] These types of agreements, which are preliminary only in form, will be considered in more detail below.[203] Type II preliminary agreements outline the major terms of the transaction, but leave certain terms open for future negotiation.[204]

Judge Leval explained that parties "can bind themselves to a seemingly incomplete agreement in the sense that they accept a mutual commitment to negotiate in good faith in an effort to reach final agreement within the scope that has been settled in the preliminary agreement."[205]

Applying these principles to the facts, he concluded from the surrounding circumstances and the express terms of the loan commitment letter in question that the parties intended to conclude an agreement to negotiate in good faith.[206]

Generally, however, it appears to be easier for courts to enforce express obligations to negotiate in good faith.[207] It also cannot be ignored that some American courts are less progressive and remain unwilling to enforce agreements to negotiate at all.[208] In *Feldman v Allegheny Int'l*[209] for example, the court found that the agreement to negotiate was too uncertain to be enforceable. According to the court, "[g]ood faith is no guide," because both parties will and are entitled to pursue the best deal, even if that entails unreasonable demands.[210] It is interesting that in this case, the agreement

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[201] Eisenberg *Principles of Contract Law* 507.

[202] (1987) 670 F Supp 491 (S D N Y) 494.

[203] See ch 3 (3 3 2).

[204] 499.

[205] 498.

[206] 499. Judge Leval labelled this a type II preliminary agreement.

[207] Blum *Examples* para 10 6 4; see *VS & A Communication Partners Lp v Palmer Broadcasting Ltd* (1992) WL 339 377 (Del CH) 9 where the court distinguished between an express obligation and an implied obligation and concluded that such an obligation could not be inferred into the specific preliminary agreement.

[208] Sanders 2006 *UC Davis Bus LJ* 219.

[209](1988) 850 F 2d 1217 (7th Cir) 1223.

[210] 1223.

in question had been concluded at a very early stage in negotiations and "nearly all the details remained open".[211] There was also no express obligation to negotiate in good faith.

(b) The content of an obligation to negotiate in good faith and the importance of its enforcement

From the above analysis, it is clear that some American courts are willing to enforce express or even implied obligations to negotiate in good faith in pre-contractual agreements and are more inclined to do so where "major terms" of the principal contract have been recorded.[212] This in turn gives rise to a very difficult question, namely what does an obligation to negotiate in good faith actually entail?

In *Tribune Co*[213] Judge Leval explained that this obligation prevents a party from "renouncing the deal, abandoning negotiations, or insisting on conditions that do not conform to the preliminary agreement".[214] This obligation does not prevent a party from pursuing her own interests in a business transaction; it merely requires her to negotiate seriously and genuinely in an attempt to reach consensus and if she has complied, her obligation will be discharged even if no contract materialises.[215] It is entirely possible that negotiations will break down because of a reasonable disagreement regarding open terms or final negotiations detect hidden problems with the terms of the earlier agreement that are unresolvable. [216]

Summers defines good faith by excluding bad faith conduct.[217] Eisenberg suggests that in most cases it will be clear whether the party acted in bad faith, by for example, conducting parallel negotiations with third parties or simply breaking off negotiations

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[211] 1223.

[212] *Siga Technologies Inc v PharmAthene Inc* (2013) 67 A 3d 330 (Del) 345; Farnsworth *Contracts* 200-201.

[213] (1987) 670 F Supp 491 (S D N Y).

[214] 498.

[215] *Feldman v Allegheny International Inc* (1988) 850 F 2d 1217 (7th Cir) 1223; *A/S Apothekernes Laboratorium for SpecialPraeparater v IMC Chemical Group* (1989) 873 F 2d 155 (7th Cir) 159-160; Pannebakker *Letter of Intent* 164.

[216] Eisenberg *Principles of Contract Law* 514.

[217] "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968) 54 *Va LR* 195 196,232-234; see also *Venture Associates Corporation v Zenith Data Systems Corp* (1996) 96F 3d 275 (7th Cir) para 3.

without any reason.[218] Bad faith may often be subtle and a party will sometimes escape liability as a result, but this does not justify the unenforceability of agreements to negotiate.[219] American courts that were willing to accept that the obligation to negotiate in good faith is enforceable had little difficulty giving content to the obligation and ultimately the scope and content will become more certain through judicial development.[220]

Given some of the difficulties that can arise in the enforcement of an obligation to negotiate, the question arises why some American courts are altering traditional contract law rules to enforce these agreements? According to Creed, the purpose of these agreements is to manage the allocation of risk between parties in the course of negotiations.[221] Agreements such as memoranda of understanding, letters of intent and term sheets are concluded at a time when parties have progressed in contractual negotiations and reached a stage that requires one or both of them to make substantial relationship-specific investments and potentially forgo other commercial opportunities without assurance regarding the materialisation of the final contract.[222] It appears that courts gradually moved towards the recognition of this intermediate stage of contracting to remedy the inadequacy of pre-contractual liability from other sources of law. “Embedding” this intermediate contractual obligation in pre-contractual agreements gives a contracting party the assurance that his pre-contractual investments are protected in the sense that the other party is no longer free to break off negotiations in bad faith at any time and for any reason without liability.[223] On this understanding, an obligation to negotiate protects a party’s investment during the pre-contractual phase against the other party’s bad faith conduct, which may include, delaying negotiations, proposing unreasonable terms and holding out until the other party accepts prejudicial terms to avoid losing substantial investments made into negotiations.[224]

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[218] Eisenberg *Principles of Contract Law* 513.

[219] 514.

[220] Sanders 2006 *UC Davis Bus LJ* 207,218,220.

[221] JM Creed “Integrating Preliminary Agreements into the Interference Torts” (2010) 110 *Colum LR* 1253 1254 1272-1273.

[222] 1254, 1272-1274.

[223] 1273.

[224] 1274.

The enforceability of agreements to negotiate in some American states and the proposed rationale for their enforcement provides valuable insight into addressing the issue of agreements to agree and pre-contractual liability in South Africa. This enables some informed conclusions regarding future legal development to be made.

(c) The possibility of courts filling in outstanding terms

Although the issue of an obligation to negotiate in good faith and the issue of incomplete agreements or preliminary agreements subject to contract are conceptually distinct, there is often an overlap, as incomplete agreements may have an express or implied obligation to negotiate outstanding terms in good faith.[225] The question of enforceability of an incomplete agreement will depend on the intention to be bound or the animus contrahendi, which will be considered in further detail below. However, for now it should be acknowledged that American law is extremely receptive to filling in outstanding terms in order to give effect to the intention of the parties.

(iii) German Law

The legal position in civil-law systems differs vastly from that of the common-law systems considered thus far. In civil-law systems, the overarching obligation to negotiate in good faith is recognised.[226] It has already been highlighted that this obligation generally arises from the application of principles of both the laws of delict and contract.[227] German law for example, developed the doctrine of *culpa in contrahendo* (fault in negotiating) which imposes liability inter alia for a party's blameworthy conduct in the course of negotiations that prevents the final contract from being concluded.[228] Obviously this is conceptually distinct from the contractual obligations potentially arising from an agreement to negotiate discussed above. In Germany the obligation to negotiate in good faith and the accompanying remedy are generally not of a contractual nature,[229] but imposed ex lege upon commencement of

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[225] Eisenberg *Principles of Contract Law* 504.

[226] Trakman & Sharma 2014 *CLJ* 606.

[227] Trakman & Sharma 2014 *CLJ* 606; Hutchison 2011 *SALJ* 283.

[228] RB Lake "Letter of Intent: A Comparative Examination under English, U.S., French and West German Law" (1984) 18 *Geo Wash J Int'l L & Econ* 331 352.

[229] Trakman & Sharma 2014 *CLJ* 608-609.

negotiations and requires parties to consider each other's interest.[230] The legal position in Germany provides important insights into duties arising from contractual undertakings to negotiate, and how these duties differ from those relating to how parties should negotiate in general.[231]

German law recognises the validity of two types of "pre-contractual" agreements that are not found in common-law jurisdictions. The so-called *Vorvertrag* which has already been discussed in chapter 2[232] and a *Vorfeldvertrag*.[233] The latter agreement imposes specific pre-contractual obligations that regulate the manner in which negotiations are conducted. The fact that parties have concluded such agreements may be relevant for purposes of the application of the pre-contractual duties set out in the German Civil code, *Bürgerliches Gesetzbuch* ("BGB") which incorporates the theory of *culpa in contrahendo*.[234] These duties and their practical application will analysed in chapter 5 as the existence of a contract is not a prerequisite to their application.

For now it is sufficient to note that if parties have concluded a pre-contractual agreement it is more likely that a court will find that negotiations have "commenced" for purposes of section 311(2) BGB which provides that the pre-contractual duties set out in section 241(2) will apply to negotiating parties.[235] Whether a pre-contractual agreement does so will depend on the nature of the agreement.[236] If the agreement for example contains contractual obligations, section 311(2)(1) BGB dictates that the duties set out in section 311(2) BGB will arise.[237] If parties conclude a non-binding pre-contractual agreement regarding an envisaged transaction section 311(2)(3) BGB, a "catch-all", provision allows for the obligations set out in section 241(2) BGB to arise.[238]

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[230] Trakman & Sharma 2014 *CLJ* 607-610; J Cardenas "Deal Jumping in Cross-Border Merger & Acquisition Negotiations: A Comparative Analysis of Pre-Contractual Liability Under French, German, United Kingdom and United States law" (2013) 9 *NYU JL & Bus* 941 947,969.

[231] Trakman & Sharma 2014 *CLJ* 607.

[232] See ch 2 (2 4).

[233] Lake (1984) *Geo Wash J Int'l L & Econ* 345-346.

[234] C Kunze *The Letter of Intent, with Special Emphasis on its Relevance in International Trade Law* LLM thesis, Stellenbosch University (2014) 30; Lake *Geo Wash J Int'l L & Econ* 352.

[235] Kunze *The Letter of Intent* 30.

[236] 30-31.

[237] 30-31.

[238] 31.

Section 241(2) imposes a legal obligation on parties to negotiate in good faith, which is conceptually distinct from a contractual obligation to negotiate in good faith because it goes further than merely precluding bad faith conduct, by requiring of a party to take into account "the rights, legal interest and interests of the other party" in the course of negotiating.[239]

In conclusion German law recognises that pre-contractual agreements may amount to pre-contracts (*Vorvertrag*)[240] that impose contractual obligations or negotiation agreements which do not impose contractual obligations to conclude the final contract. However, both of these agreements can give rise to the imposition of the pre-contractual duties set out in section 242(1) BGB.[241] Babusiaux suggests that because civil-law systems recognise the obligation to negotiate in good faith, even in the absence of an agreement, agreements to negotiate should in principle be enforceable.[242] In this regard the doctrine of *culpa in contrahendo* can be applied to interpret and give content to the pre-contractual agreement and establish whether it merely reiterates the legal duty to negotiate in good faith.[243] Ultimately, there is less reason for doctrinal debates regarding the nature of these pre-contractual agreements in civil-law systems, such as Germany, since the law of pre-contractual liability is so well developed.[244]

3 2 2 2 International instruments

International instruments such as the UNIDROIT Principles of International Commercial Contracts ("PICC")[245] and Principles of European Contract law ("PECL")[246] make provision for liability for negotiating in bad faith (or contrary to good faith) even in the absence of an agreement to that effect.

It is odd that the PICC, which was formulated to regulate contracts, contains article

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[239] Sec 241(2) BGB.

[240] See ch 2 (2 4).

[241] Kunze *The Letter of Intent* 34.

[242] "Art 2:301: Negotiations Contrary to Good Faith" in Jansen and Zimmermann (eds) *Commentaries on European Contract Laws* 365.

[243] 366.

[244] See ch 5 regarding pre-contractual liability; see also Babusiaux "Art 2:301: Negotiations Contrary to Good Faith" Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 365.

[245] Art 2.1.15.

[246] Art 2:301.

2.1.15, which essentially deals with pre-contractual liability where negotiations do not give rise to a contract. The existence of a contract is a prerequisite for the application of the PICC, because for such law to apply parties must either have concluded a contract where they did not select any law to govern such contract or expressly provided in their contract that the PICC will govern such contract. This gives rise to the problem that article 2.1.15 can only apply if parties have concluded a valid contract to negotiate or are renegotiating terms of an existing contract. Therefore, these principles are not directly applicable to negotiations broken off prior to the conclusion of some form of contract.

Nevertheless, as Rios points out, this provision can inform the development of international instruments and national rules in its regulation of pre-contractual liability. For example, an arbitral tribunal applied the PICC in support of the conclusion that an agreement to negotiate in good faith is enforceable in terms of the law of the state of New York (which was found by the tribunal to be the applicable law). It is argued here that like the PICC, the PECL which contains very similar provisions can also influence the development of national law in the similar manner.

Article 2.1.15 of the PICC read with comment 3 thereto also gives guidance as to the obligation imposed by an enforceable agreement to negotiate – parties will at the very least be obliged to negotiate seriously towards conclusion of a final contract. It does not however impose an obligation on parties to conclude the final contract.[247] This can aid in providing certainty as to the content of the obligation to negotiate in good faith and support the development of national law to recognise the enforceability of agreements to negotiate.

3 2 2 3 South African law

In terms of South African law, agreements to agree or to reach consensus are regarded as void for uncertainty because neither party can be compelled to reach consensus.[248] In a similar vein, agreements to negotiate a future contract, but without necessarily having to reach consensus, have also traditionally been treated as too

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[247] Art 2.1.15 read with comment 3.

[248] Sharrock *Business Transactions Law* 92; G Bradfield *Christie's Law of Contract in South Africa* 7 ed (2016) 47; Du Plessis "Possibility and Certainty" in *Contract* 220.

vague to give rise to an enforceable contract.[249]

In *Premier, Free State v Firechem Free State (Pty) Ltd*[250] the court explained that "an agreement that the parties will negotiate to conclude another agreement is not enforceable, because of the absolute discretion vested in the parties to either agree or disagree."[251] There is no guarantee that parties to the agreement to agree will actually reach consensus and conclude the final contract.[252] It is herein that the uncertainty lies.

The failure to draw a proper distinction between agreements to agree and agreements to negotiate contributes to a growing misconception regarding the nature and purpose of an agreement to negotiate. As Sharrock explains, an agreement to negotiate a future contract is functionally distinct from an agreement to agree; the former agreement does not oblige the parties to conclude the final contract, but rather binds them to negotiate towards such conclusion.[253] The agreement to negotiate does not seek to regulate the end result of negotiations, but rather the negotiation process itself.[254]

The traditional legal position regarding agreements to negotiate has recently undergone some development.[255] This is of particular significance in light of the suggestion internationally that these agreements may constitute a suitable middle ground between the realm of no contract (pre-contractual phase) and a final contract (contractual liability in respect of the envisaged transaction). The types of agreements to negotiate that currently meet the certainty requirement and the prospects of further development will be examined to determine whether the recognition of such a middle ground is possible in South Africa.

(i) Agreements to negotiate that contain a deadlock-breaking mechanism

Negotiation clauses can form part of a wide variety of agreements to negotiate and as

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[249] Bradfield *Law of Contract* 47; see also *Premier, Free State v Firechem Free State (Pty) Ltd* 2000 4 SA 413 (SCA) para 35.

[250] 2000 4 SA 413 (SCA).

[251] Para 35.

[252] D Bhana, E Bonthuys & M Nortje *Student's Guide to the Law of contract* 4 ed (2015) 101.

[253] Sharrock *Business Transactions Law* 93.

[254] 93.

[255] Bradfield *Law of Contract* 47.

this analysis proceeds, it will become clear that the type of agreement being dealt with has a determinative impact on the enforceability of such agreement. In this section we shall consider the first type of agreement, namely the agreement to negotiate that contains a deadlock-breaking mechanism.

In *Letaba Sawmills (Pty) Ltd v Majovi (Pty) Ltd* [256] (*Letaba*) parties had concluded a lease with an option to renew upon expiry of such lease. The renewal option contained a negotiation clause, which required parties to negotiate regarding the rental payable "subject to the rental being fixed within the limits of market related prices, the timber on the leased property and the rental payable in respect thereof". In the event that they were unable to agree an arbitration provision provided for such rental to be determined by an arbitrator.[257] The question was whether this negotiation obligation was too vague and uncertain and thus rendered the renewal option clause unenforceable.

As a point of departure, the court acknowledged that in the absence of the arbitration clause the negotiation clause would be unenforceable. They explained that "an agreement to negotiate and to agree on the rent is unenforceable". The fact that parties had set limits within which such rental was to be determined would not affect the unenforceability of the agreement to negotiate.[258] However, the existence of the arbitration clause accompanying the negotiation clause rendered the renewal option sufficiently certain to be enforced because it provided a mechanism by which rental could be determined if parties could not reach agreement on such rental through negotiation.[259]

Further clarification regarding agreements to negotiate was provided in the leading case of *Southernport Development (Pty) Ltd v Transnet Ltd*[260] *("Southernport")*. In this case the court confirmed that the legal principles enunciated in the Australian case of *Coal Cliff Collieries (Pty) Ltd v Sijehama,*[261] and the three possible types of agreements to negotiate identified there, accords with South African law.[262] The three

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[256] 1993 1 SA 768 (A) 773C.

[257] 773C.

[258] 773I-774A.

[259] 774B.

[260] 2005 2 SA 202 (SCA).

[261] 1991 24 NSWLR 1 27A-27B.

[262] 2005 2 SA 202 (SCA) para 15-16.

types can be summarised as follows. First, there are agreements to negotiate that are intended to be binding and therefore contain some deadlock-breaking mechanism to resolve disputes.[263] Secondly we have agreements that are of such a nature that uncertainty or vagueness may be resolved by the court with reference to a "readily ascertainable external standard".[264] Lastly there are agreements to negotiate in good faith which 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."[265]

In *Southernport*[266], Ponnan AJA regarded *Premier, Free State v Firechem Free State (Pty) Ltd*[267] as an example of the third type of agreement and explained that the agreement to negotiate in that case did not contain a deadlock-breaking mechanism, and as such was too uncertain to be enforceable. In *Southernport*[268] the agreement to negotiate was held to be certain and thus enforceable due to the presence of an arbitration clause that "prescribes what further steps should be followed in the event of a deadlock between the parties".[269] In the absence of some deadlock-breaking mechanism a court cannot compel parties to agree on outstanding terms of the envisaged transaction.[270]

In *Southernport*[271] the court emphasises the importance of the obligation to negotiate in good faith being linked to a deadlock-breaking provision. This suggests that express reference to an obligation to negotiate in good faith is not of itself sufficient to render the agreement certain. Enforcing open-ended standards such as good faith is difficult if not impossible in the absence of an ascertainable objective standard to measure the parties' conduct.[272]

The *Southernport* principles were confirmed by the Constitutional Court in the more

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[263] Para 17.

[264] See e.g. *Letaba Sawmills (Edms) Bpk v Majovi (Edms) Bpk* 1993 1 SA 768 (A) paras 8, 16.

[265] See e.g. *Premier, Free State v Firechem Free State (Pty) Ltd* 2000 4 SA 413 (SCA) para 35.

[266] 2005 2 SA 202 (SCA) paras 11,16.

[267] 2000 4 SA 413 (SCA) para 35.

[268] 2005 2 SA 202 (SCA) para 17.

[269] Para 11.

[270] C Lewis "The Uneven Journey to Uncertainty in Contract" (2013) 76 *THRHR* 80 86.

[271] 2005 2 SA 202 (SCA) paras 11,17.

[272] *Makate v Vodacom (Pty) Ltd* 2016 4 SA 121 (CC) para 96.

recent decision of *Makate v Vodacom.*[273] In this case the court recognised the validity of an agreement to negotiate the compensation payable for Makate's "please call me idea". The court found that the agreement was valid and enforceable because it provided for the CEO of Vodacom to determine the compensation payable if the parties were unable to agree.[274] The court concluded that price determination by the CEO constituted a valid deadlock-breaking mechanism.[275]

These cases confirm the position in common-law that agreements to negotiate are enforceable if they contain a deadlock-breaking mechanism that can be applied in the event that negotiating parties are unable to reach agreement.[276] This development raises the following question: why does the presence of a deadlock-breaking mechanism render an otherwise unenforceable agreement to negotiate enforceable? It is argued here that the presence of a deadlock-breaking mechanism attaches consequences to the failure to negotiate and provides an incentive for the parties to comply with their negotiation obligations.[277]

There is an important qualification to the enforceability of these types of agreements to negotiate. In *Southernport,* the court explains that a deadlock-breaking mechanism, in this case the arbitrator, cannot make the entire contract for the parties "which they themselves have not put into words"; "the arbitrator was entrusted with putting flesh onto the bones of a contract already concluded by the parties".[278] Therefore we are in fact dealing with a specific type of agreement to negotiate that outlines most of the terms of the final contract but contains some outstanding terms that have been left to future negotiation. This therefore excludes the enforceability of agreements solely recording an arrangement to negotiate a second contract in the future and even agreements traditionally labelled as MOU's or term sheets that outline the terms of the envisaged transaction in a non-binding manner.

Hutchison, for purposes of his analysis of agreements to negotiate, assumes that a negotiation clause must form part of a preliminary agreement "which is binding and

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[273] Para 96.

[274] Paras 94-103.

[275] Para 101.

[276] Para 97.

[277] See ch 4.

[278] 2005 2 SA 202 (SCA) para 17.

imposes on them [the parties] a set of contractual obligations", but leaves certain open terms to future negotiations in good faith; otherwise the negotiation clause would fall into the third category set out in *Southernport*, which is unenforceable.[279] He explains with reference to the case of *CGEE Alsthom Equipments et Enterprises Electriques, South African Division v GKN Sankey (Pty) Ltd*[280] ("*CGEE*") that an agreement can be binding notwithstanding the existence of outstanding matters left to further negotiation.[281] He goes on to indicate that the grey area lies in the enforceability of binding preliminary agreements with open terms to be negotiated in good faith where there is no deadlock-breaking mechanism.[282] In this regard, Jafta J in *Makate v Vodacom (Pty) Ltd*[283] explains that:

> "[w]hether an agreement to negotiate in good faith is enforceable where there is no deadlock-breaking mechanism remains a grey area of our law. This is because *Firechem* suggests that it is not enforceable, while *Everfresh* suggests otherwise."[284]

The core issue that we therefore need to address in this chapter is whether South African law can and should be developed to enforce agreements to negotiate even in the absence of a deadlock-breaking mechanism. This requires the consideration of different issues. Firstly, can an agreement to negotiate outstanding terms in good faith and an agreement solely recording an arrangement to negotiate a second contract in the future be enforceable even in the absence of a deadlock-breaking mechanism? Secondly what would the content and consequences of the respective agreements to negotiate be? Thirdly what would the obligation to negotiate in good faith entail? South African courts have thus far used the presence of a deadlock-breaking mechanism to determine the validity of a negotiation clause, but have given limited guidance on the content of the obligation to negotiate in good faith. Should the law be further developed to accord with the legal position in common-law systems such as America and civil-law systems such as Germany? It is to these questions that our discussion now turns.

(ii) Pre-contractual agreements that do not contain a deadlock-breaking

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[279] 274.

[280] 1987 1 SA 81 (A) 92C-F.

[281] Hutchison 2011 *SALJ* 276.

[282] 274.

[283] 2016 4 SA 121 (CC) para 100.

[284] Para 100.

mechanism

The effect of the absence of a deadlock-breaking mechanism on the contractual enforceability of negotiation clauses will be considered in the context of agreements that outline most of the terms of the principal contract and are intended to be binding. It will also be considered in the context of so-called independent agreements to negotiate that are entered into prior to the main contract and outline at least some of the terms of the principal contract in a non-binding manner or exclusively record an arrangement to negotiate the principal contract in the future. Whether the fact that the negotiation obligation is expressly stated to be in good faith has an impact on enforceability will also be considered.

In *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd*[285] the court had to establish whether to grant an interim interdict to the applicant. It was submitted on behalf of the applicant that their prima facie right in this instance arose from an agreement to negotiate a future contract, albeit that it was not expressly argued that the negotiations had to be conducted in good faith.[286] This naturally brought into question the validity of such an agreement to negotiate.[287]

In considering this question, Blignault J referred to the Australian case of *United Group Rail Services Limited v Rail Corporation New South Wales*[288] (decided after *Coal Cliff*). He first noted that in *United Group* there was an express reference to "genuine and good faith negotiations" and that the agreement contained an arbitration clause,[289] but to him this did not constitute a material difference between the two cases. According to Blignault J, in terms of South African law it was in principle possible to imply standards of reasonableness and good faith into an agreement. He then proceeded to give the practical example of the implied standard of *arbitrium boni viri* being applied to validate contract provisions, which would otherwise be too vague to enforce.[290] Crucially, according to Blignault J, this standard could potentially be implied into agreements to negotiate:

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[285] 2012 6 SA 96 (WCC) para 22.

[286] Para 22.

[287] Para 23.

[288] 2009 NSWCA 177 para 65.

[289] 2012 6 SA 96 (WCC) paras 26,29.

[290] Para 27

> "In principle it seems to me that a standard such as the *arbitrium boni viri* could be applied to the conduct of a contracting party who undertakes an obligation to negotiate a further agreement. Such a party would be obliged to act honestly and reasonably in the conduct of the negotiations and a court would be able to determine whether it complied with such standards."[291]

After considering and settling the insignificance of the first distinction relating to the wording of the clauses, Blignault J considered a second distinction between the cases, namely the absence of a deadlock-breaking mechanism (more specifically an arbitration clause) in the preliminary agreement he was faced with. He then reached the following conclusion:

> "In my view, however, the absence of an agreed reference of a dispute to an arbitrator is not a vital point of distinction. The arbitrator would in such a case be expected to apply standards of reasonableness and good faith to the conduct of the negotiating parties … [T]he process of the application of such standards by a court would not in principle differ from that to be applied by an arbitrator."[292]

This represents an important development. It is argued that even in the absence of a deadlock-breaking mechanism, an agreement to negotiate can be enforceable because it imposes upon the parties an implied obligation to negotiate honestly and reasonably, and compliance can be objectively determined by the courts.[293] This renders the duty sufficiently certain to be enforced.[294] The *obiter dictum* statements of Moseneke DCJ and the minority judgment of Yacoob J in *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd*[295] ("*Everfresh")* also seem to support this proposition.[296]

McKerrow[297] highlights that the court a quo's judgment in *Brink v The Premier of the State Province* (*"Brink")*[298] is also of potential interest as far as agreements to negotiate without a deadlock-breaking mechanism are concerned. This case dealt with a clause in a lease granting an option of renewal on the same terms or new terms as

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[291] Para 28.

[292] Para 30.

[293] Sharrock *Business Transactions Law* 93; McKerrow 2017 *Stell LR* 331.

[294] Bradfield *Law of Contract* 48.

[295] 2012 1 SA 256 (CC) paras 24-26,70-72.

[296] See the discussions of this case in 3 5; McKerrow 2017 *Stell LR* 315.

[297] McKerrow 2017 *Stell LR* 310.

[298] 2008 JDR 1062 (O).

agreed upon.[299] The court in effect found that this clause imposed an obligation to negotiate new terms where necessary, and the parties could not refuse to comply with such obligation.[300] This decision stands in strong contrast to preceding case law such as *Southernport* and *Letaba Sawmills* where the necessity of a deadlock-breaking mechanism was confirmed.[301] The court[302] referred to a dictum in *Biloden Properties (Pty) Ltd v Wilson*[303] explaining that where negotiations fail, there will be no contract, but parties would still have been obliged to negotiate in an attempt to reach agreement.[304] Once this obligation has been discharged there will be no further obligations if negotiations fail to produce a contract.[305] Again, it bears pointing out that an agreement to negotiate is not an agreement to agree. It is unfortunate, though, that when the matter came before the Supreme Court of Appeal, this aspect was not addressed.[306] The high court decision regarding the enforceability of a negotiation clause has therefore yet to be scrutinised.[307]

The enforceability of agreements to negotiate even in the absence of a deadlock-breaking mechanism came before the Constitutional Court for the first time in the *Everfresh*[308] case. This case dealt with the validity and enforceability of a clause in a lease which gave a right of renewal on the same terms and conditions, save the rental which was to be agreed upon by the parties.[309] The court a quo reached the conclusion that agreements to agree are unenforceable, and even if such a clause imposed an obligation to negotiate in good faith, it would still be unenforceable due to vagueness.[310] Everfresh, seeking leave to appeal in the Constitutional Court, raised a new argument that the common-law on agreements to negotiate requires development

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[299] Para 20.

[300] Para 20.

[301] McKerrow 2017 *Stell LR* 311.

[302] 2008 JDR 1062 (O) para 15.

[303] 1946 NPD 736.

[304] 739.

[305] 1946 NPD 739; McKerrow 2017 *Stell LR* 311.

[306] *Brink v Premier of the Free State Province and Another* 2009 4 SA 420 (SCA) para 11.

[307] McKerrow 2017 *Stell LR* 311.

[308] 2009 4 SA 420 (SCA).

[309] Para 3-5.

[310] Para 10-11.

to accord with public policy and constitutional values.[311] The majority refused to grant leave to appeal on the basis of Everfresh's failure to raise this argument in the court a quo.[312]

The court, nonetheless, went on to consider whether Everfresh's argument had any prospects of success. Some important observations were made in this regard, which may in the future inform the development of the South African legal position regarding agreements to negotiate.

Moseneke DCJ recognised that the common-law may require parties to an agreement to negotiate, to "try and reach agreement" on the outstanding terms of their agreement.[313] He concluded that:

> "If that were so, then the parties' bargain was that they would try to agree, and the age-old contractual doctrine that agreements solemnly made should be honoured and enforced (pacta sunt servanda) would bolster Everfresh's case that the law should be developed to make an agreement of this kind enforceable." [314]

It is of fundamental significance that the court did not regard the presence of a deadlock-breaking mechanism as a prerequisite to the enforceability of the agreement to negotiate.[315]

In light of *Indwe* and *Everfresh* it is somewhat surprising that in the case of *Roazar v Falls Supermarket CC*[316] ("*Roazar*") the court again confirmed the principles as set forth in the *Southernport* case, making no reference to the case of *Indwe*. The court found that the presence of a deadlock-breaking mechanism is a prerequisite for validity.[317] The court went on to consider whether the common-law in this regard requires development.[318] The observations of Lewis[319] regarding the problems with developing the common-law were noted by the court.[320] These included determining

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[311] Paras 16, 18-19.

[312] Paras 63-64, 80.

[313] Para 69.

[314] Para 70.

[315] Du Plessis "Possibility and Certainty" in *Contract Law* 221.

[316] 2018 3 SA 76 (SCA) para 13.

[317] Para 15.

[318] Para 16-21.

[319] See Lewis 2013 *THRHR* 80.

[320] *Roazar v Falls Supermarket CC* 2018 3 SA 76 (SCA) para 16, 20-21.

how to develop the common-law to enforce agreements to negotiate, what a duty to negotiate in good faith entails, how it would be enforced and how courts would handle disputes regarding outstanding terms.[321]

The court concluded that these complications were illustrated by the present case. The contract did not provide the length of time for which the parties were obliged to negotiate, or the criteria to determine whether parties negotiated in good faith. It is unclear how a court should resolve this.[322] Roazar no longer wished to enter into the lease agreement and in the absence of a deadlock-breaking mechanism, disputes could not be resolved.[323] The court did not want to impose upon the parties a contract that they did not intend.[324]

The *Roazar* decision as well as the line of supporting preceding case law was confirmed in the most recent case of *Sheperd Real Estate Investments (Pty) Ltd v Roux Le Roux Motors CC*.[325] The Supreme Court of Appeal once again concluded that an agreement to negotiate is unenforceable in the absence of a deadlock-breaking mechanism and relied on both local and English case law (discussed in this thesis) to justify its position.[326] In doing so however, the court failed to refer to the *Everfresh* decision at all and only referred to the *Indwe* decision in passing. It is unclear why the courts failed to consider these cases, or to explain why the reasoning in these cases should not be applied.

These more recent judgments, seem inconsistent with the obiter views expressed by the Constitutional Court in *Everfresh,* which suggested that the common-law could be developed to enforce such an agreement to negotiate. Furthermore, some of the complications to the development of the common-law, as highlighted in *Roazar*, may have been overstated, particularly in light of the solutions provided by *Indwe*. The merits of the arguments made by Lewis, which were relied upon in *Roazar*, will be considered in light of contrasting arguments and potential solutions provided by other academics.

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[321] Lewis 2013 *THRHR* 92-94.

[322] 2018 3 SA 76 (SCA) para 22.

[323] Paras 20, 23-24.

[324] Paras 20, 24.

[325] (1318/2018) [2019] ZASCA 178 (02-12-2019) paras 9-10.

[326] Paras 10-11, 15.

The two aspects to address are potential solutions to uncertainty regarding the absence of a deadlock-breaking mechanism and the content of the obligation to negotiate, which presumably has to be in good faith.

(a) Solutions to the absence of a deadlock-breaking mechanism

Academics have proposed various solutions to resolve this uncertainty. Hutchison draws an analogy between pre-emption contracts and agreements to negotiate outstanding terms in good faith.[327] Pre-emption contracts give rise to similar conceptual issues regarding the requirement of certainty but are nevertheless enforceable. This analogy is insightful because it reveals that courts by recognising pre-emption contracts are willing to enforce "a duty to negotiate an agreement at a future date."[328] Furthermore this obligation has been interpreted by the courts to require a "*bone fide*" offer to be made by the grantor.[329] This is significant, because the pre-emption contract is enforceable in principle, even in the absence of a deadlock-breaking mechanism, and it appears to require parties to act in good faith.[330] Bhana similarly suggests that the "legal reasoning used to justify the validity of the pre-emption contract" may also be used to recognise the validity of agreements to negotiate.[331]

Hutchison and Bhana also draw a further analogy between agreements to negotiate outstanding terms and contracts granting a "unilateral power" to one of the parties to vary or determine the outstanding term(s) of a contract.[332] Courts have recognised the validity of such a power, if it is exercised with the *arbitrium bono viri*.[333] Hutchison expresses the view that this principle could be extended to allow a court or tribunal to determine outstanding terms in a binding preliminary agreement that essentially confers a bilateral discretion upon the parties.[334] He argues that if consensus has been

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[327] Hutchison 2011 *SALJ* 276.

[328] Hutchison 2011 *SALJ* 278; see also *Soteriou v Retco Poyntons (Pty) Ltd* 1985 2 SA 922 (A) 929-934; D Bhana "The Contract of Pre-emption as an Agreement to Agree" (2008) 71 *THRHR* 570.

[329] *Soteriou v Retco Poyntons (Pty) Ltd* 933-934.

[330] Hutchison 2011 *SALJ* 283,294.

[331] Bhana 2008 *THRHR* 571.

[332] Hutchison 2011 *SALJ* 277, 279, see also Bhana 2008 *THRHR* 578.

[333] *NBS Boland Bank v Oneberg River Drive CC* 1999 4 SA 928 (SCA) para 25; *Eramus v Senwes* 2006 3 SA 529 (T) 537-538.

[334] 2011 *SALJ* 279, 282; see for further analysis the discussion in ch 4.

reached on the majority of the terms of the contract, it would not be "too big a stretch" for the court to determine an outstanding term such as the purchase price or rental based on what is objectively reasonable.[335] Good faith (as an underlying value of contract law) and public policy could constitute an appropriate means of limiting such a power.[336] This power could be available as an optional remedy for courts faced with breach of an obligation to negotiate in good faith.[337] Hutchison concludes that "good faith or some other standard of objective reasonableness or fairness" could be utilised as an underlying basis for the development of the law to enforce agreements to negotiate even in the absence of a deadlock-breaking mechanism.[338]

At this point it is necessary to draw attention to the distinction between subjective good faith and objective good faith. Subjective good faith is a subjective state of mind requiring honesty and the absence of bad faith.[339] Objective good faith in contrast is an objective standard which encompasses a duty of reciprocity, fair dealing and "having regard for the legitimate interests of the other party".[340]

McKerrow suggests that the common-law should be developed so that good faith, as an objective standard, is applied to impart certainty on the obligations imposed by an agreement to negotiate.[341] He argues that this standard of objective reasonableness can also be utilised by courts to fulfil the function of "deadlock breaker" and thus remedy the absence of a deadlock-breaking mechanism in the event of breach of certain agreements to negotiate.[342] The possibility of good faith, as an objective standard, being applied to enforce agreements to negotiate will be considered in more detail below.[343]

It is necessary to enquire into the reason for the absence of a deadlock-breaking

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[335] 282.

[336] 282.

[337] 282.

[338] 282.

[339] AM Louw "Yet Another Call for a Greater Role for Good Faith in the South African law of Contract: Can We Banish the Law of the Jungle, While Avoiding the Elephant in the Room" (2013) 16 *PER* 44 84-85.

[340] 84-85.

[341] 2017 *Stell LR* 329.

[342] 315.

[343] See ch 3 (3 5).

mechanism in order to evaluate whether it is essential to the validity of the agreement to negotiate. If parties intended to be bound by the agreement notwithstanding outstanding terms but failed to include a deadlock-breaking mechanism, then it should in theory be possible for the court to remedy that failure by fulfilling a deadlock-breaking function. This proposal is qualified insofar as it would require that the court merely be adding "flesh to the bones of a contract already concluded", or those terms should be readily ascertainable. There are strict requirements that must be met for this type of agreement to come into existence. Firstly, it must be clear from the agreement that parties intend to be bound by the contract irrespective of the outcome of negotiations and that they did not merely intend to impose an obligation to negotiate. Secondly, it must be possible for the court to derive a guiding standard or framework which can be applied to determine the outstanding terms. In the absence of such a framework the courts would be displacing party autonomy and imposing contractual terms on the parties which they neither agreed to nor intended.

The absence of a deadlock-breaking mechanism, however could well indicate the absence of an intention to be bound by the substantive terms of the contract irrespective of the outcome of negotiations. If for example, the intention of parties to be bound by the terms of the agreement is dependent upon reaching consensus on open terms, then a failure to agree would result in an absence of an intention to be bound. If parties cannot reach agreement on outstanding terms, they may not wish to be bound by the agreement at all, even if outstanding terms could be determined by the application of a deadlock-breaking mechanism. In this situation it is necessary to ask what parties intended by including an obligation to negotiate. Did they intend to bind themselves to a legal obligation to conclude the envisaged contract, to negotiate in good faith in an attempt to reach agreement, or were they merely concluding an agreement akin to a gentleman's agreement that is not binding.

The concerns raised by Lewis and the court in *Roazar* regarding the uncertainty of agreements to negotiate in the absence of a deadlock-breaking mechanism conflate agreements to agree and agreements to negotiate.[344] Scholars criticising the traditional legal position have been particularly vocal regarding the courts'

[344] See introduction to 3 2 2 1 regarding the distinction between an agreement to agree and agreement to negotiate.

interpretation of all agreements to negotiate as providing a guarantee that the envisaged main contract will be concluded, whereas an agreement to negotiate only increases the likelihood of the principal contract being concluded.[345] In *Schwartz NO v Pike,*[346] the court alludes to the difference between an agreement to negotiate and an unenforceable agreement to agree.[347] In this regard a comparison can also be drawn between agreements to negotiate and pre-emption contracts.[348] A pre-emption contract also does not guarantee the conclusion of the envisaged transaction.[349]

In *Everfresh*,[350] for example, it was clear that the parties did not contemplate that the agreement to negotiate would oblige them to conclude the substantive agreement.[351] In fact, clause 3 of the agreement set out the consequences in the event that consensus was not reached. While the High Court's conclusion was based on the premise that an agreement to negotiate obliges conclusion of the substantive contract,[352] the Constitutional Court seems to recognise that an agreement to negotiate does not necessarily guarantee successful negotiations and contract conclusion.[353] This is particularly apparent from the focus that the court placed on attributing a legal content to the "obligation to negotiate in good faith".[354]

From this it is possible to infer that as long as parties have negotiated in good faith they will have complied with their obligation.[355] If this is indeed the case, then it may be necessary to re-evaluate the need for a deadlock-breaking mechanism as a pre-

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[345] D Bhana & N Broeders "Agreements to Agree" (2014) 77 *THRHR* 174; D Bhana "The Contract of Pre-emption as an Agreement to Agree" (2008) 71 *THRHR* 568 578-579; Hutchison 2011 *SALJ* 277-279, 293-295.

[346] 2008 3 SA 431 (SCA).

[347] See McKerrow 2017 *Stell LR* 310.

[348] See Hutchison 2011 *SALJ* 277-278; Bhana & Broeders 2014 *THRHR* 174.

[349] Bhana & Broeders 2014 *THRHR* 174.

[350] 2012 1 SA 256 (CC) paras 3-5,10.

[351] Bhana & Broeders 2014 *THRHR* 174; McKerrow 2017 *Stell LR* 310.

[352] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC) paras 10, 11, 57; Bhana & Broeders 2014 THRHR 174.

[353] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC) para 78; Bhana & Broeders 2014 THRHR 174; McKerrow 2017 Stell LR 310.

[354] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC) paras 18-19, 36-40, 69-72, 78; see also Bhana & Broeders 2014 *THRHR* 174.

[355] *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers* (Pty) Ltd 2012 1 SA 256 (CC) para 78; Bhana & Broeders 2014 THRHR 174; McKerrow 2017 *Stell LR* 310 330.

requisite for enforceability in South African law.[356]

It could be argued that the presence of a deadlock-breaking mechanism rather influences the type of agreement to negotiate, the nature of the contractual obligations and the type of remedies available.[357] Thus, the presence of a deadlock-breaking mechanism indicates the parties' intention to bound by the contract irrespective of the outcome of negotiations, as the mechanism is invoked if parties are unable to agree.[358] It is proposed that the absence of a deadlock-breaking mechanism in an agreement to negotiate may indicate that the parties do not intend to be bound by the future principal contract irrespective of the outcome of negotiations, but nonetheless intend to be bound by an obligation to negotiate in good faith. If parties have negotiated in good faith, their obligation will have been discharged even if no principal contract is concluded.[359] The absence of the deadlock-breaking mechanism will only become relevant once it is determined that parties failed to negotiate in good faith. The question that arises is whether the courts can in those circumstances enforce the principal contract by performing a deadlock-breaking function as a remedy for breach.

(b) Giving content to the obligation to negotiate

Determining the content of the obligation to negotiate is particularly important where there is no deadlock-breaking mechanism to establish what the consequences of a failure to negotiate are in order to render the obligation sufficiently certain to be enforceable.

It would appear that a negotiation obligation requires parties to act "reasonably and honestly in the course of negotiations.[360] Some agreements will expressly refer to good faith, but even if it is not referred to, *Indwe* seems to suggest that it can be implied in giving content to the obligation to negotiate. If this is accepted the next question is what an obligation to negotiate in good faith entails.

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[356] B Mupangavanhu "Yet Another Missed Opportunity to Develop the Common Law of Contract? An Analysis of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* [2011] ZACC 30" (2013) 27 *SJ* 148 170.

[357] See ch 4; see also McKerrow 2017 *Stell LR* 333.

[358] *Makate v Vodacom (Pty) Ltd* 2016 4 SA 121 (CC) para 103.

[359] McKerrow 2017 *Stell LR* 330-331.

[360] *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd* 2012 6 SA 96 (WCC).

In *Makate*[361] the court stated that it was both difficult and undesirable "to lay down an objective standard of good faith bargaining which the parties must undertake". The court accepted that an obligation to negotiate in good faith, precludes parties from negotiating in bad faith.[362] Hutchison argues that to impose an objective standard of good faith negotiations would excessively hinder "legitimate hard bargaining".[363] He suggests that the obligation to negotiate in good faith should preclude bad faith, which requires "something akin to *dolus"*.[364] An example of bad faith in this context is where one of party deliberately intends "to string the other party along without intending to agree".[365]

McKerrow disagrees and argues that because all contracts are *bonae fide*i,[366] the positive obligation of good faith is imported into all "contractual interactions" and this imposes a substantially higher standard than merely precluding bad faith conduct.[367] He suggests that whether an obligation to negotiate in good faith has been breached should be determined with reference to good faith as an objective standard.[368] In *Silent Pond Investments CC v Woolworths (Pty) Ltd*[369] the court concluded that a clause imposing an obligation on the parties to implement a contract in good faith was not too uncertain to be enforceable and imposed an obligation on the parties to behave in a way that will not prejudice the rights, interests or assets of the other party.

It is argued here that an agreement to negotiate imposes no more than an obligation to abstain from bad faith conduct. To impose upon the parties a positive obligation to act in good faith set a much too onerous standard and prevents the efficient conclusion of business transactions. It is for this very reason that in terms of American law an agreement to negotiate excludes bad faith conduct. Parties should still be able to pursue their own interests and derive the most economically advantageous deal, but they must avoid bad faith conduct in doing so.

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[361] 2016 4 SA 121 (CC) para 102.

[362] Para 102.

[363] 2011 *SALJ* 291.

[364] 291.

[365] 296.

[366] See *Meskin v Anglo American Corporation of SA Ltd* 1968 4 SA 793 (W) 802A.

[367] 2017 *Stell LR* 330.

[368] 329-330.

[369] 2011 6 SA 343 (D) para 64.

(iii) Conclusions that can be drawn from the comparative observations

English and South African law seem to adopt a similar approach to agreements to negotiate and only enforce negotiation clauses in contracts that contain deadlock-breaking mechanisms. However, the analysis of South African case law above promises the possibility that agreements to negotiate may be enforceable in the future even in the absence of a deadlock-breaking mechanism.

It is proposed here that South African contract law has reached a stage where it can be developed to enforce what is referred to in American law as type II preliminary agreements. This type of agreement does not guarantee conclusion of the principal contract, but it does bind parties to negotiate in good faith towards conclusion of such contract. In this regard the approach to tendering contracts in English law and the public procurement process in terms of South African administrative law can inform development of the law of contract in its regulation of agreements to negotiate. [370] Although in the South African administrative law context one is essentially dealing with a legal as opposed to contractual duty to negotiate in good faith, the enforcement of such an obligation in the administrative law context nevertheless bolsters the conclusion that the uncertainty and difficulty in enforcing a contractual obligation to negotiate in good faith is not sufficiently significant to justify its unenforceability. In fact, the rationale for the enforcement of an obligation to negotiate in good faith in an administrative law context, as derived from case law,[371] is essentially based on "an innovative private law analysis", [372] namely that parties to an agreement to agree are required to act in good faith and a court is able to determine whether a party has complied with that obligation.[373]

It may even be possible to enforce negotiation obligations contained in agreements that may be likened to the agreement with open terms in American law. However, South African courts should be cautious with the latter type of agreement and take heed of the warnings of Sanders that these types of agreements are difficult to distinguish from agreements to negotiate (which do not guarantee the materialisation

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[370] Van Huyssteen et al *Contract* 91-92.

[371] *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd* 2012 6 SA 96 (WCC).

[372] 92.

[373] 92.

of the final contract) and unenforceable agreements to agree. South African law in developing its precedent on the content and legal consequences of agreements to negotiate can take guidance from the substantial American case law and literature dealing with these agreements.

3 2 3 Partial (inchoate) or incomplete agreements

Although in chapter 2, we referred to partial agreements, there is no reference to this term in South African case law, and partial agreements do not have a legal definition. Therefore, for purposes of this chapter we shall refer to partial agreements as inchoate agreements. Inchoate or provisional agreements facilitate negotiations towards the conclusion of a final contract, but as long as essential terms are missing no contract will come into existence.[374] The analysis of the legal nature of inchoate agreements often focuses on the certainty requirement, and some cases have concluded that no contract arises from such an agreement due to uncertainty or vagueness.[375] While this may be true, as Bradfield argues in the context of South African law, the most appropriate analysis of an inchoate agreement reached in the course of continuing negotiations is that it is not binding due to an absence of an *animus contrahendi.*[376] The same approach will be adopted in this thesis. Inchoate agreements will therefore be considered more comprehensively when investigating the *animus contrahendi* requirement. It is to this requirement that the discussion now turns.

3 3 Animus contrahendi

As indicated above, the *animus contrahendi* or intention to create binding obligations is one of the pre-requisites for contract formation.[377] The presence of such an intention distinguishes contracts from other types of non-contractual agreements.[378] In

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[374] Perillo *Corbin on Contracts* 131.

[375] Bradfield *Law of Contract* 113; see also *Body Corporate of Fish Eagle v Group Twelve Investments (Pty) Ltd* 2003 5 SA 414 (W) 422.

[376] Bradfield *Law of Contract* 113; see also Farnsworth 1987 *Colum LR* 256 where he explains that the bulk of litigation on this issue in American law relates not to certainty but to the existence of the *animus contrahendi.*

[377] AJ Kerr *Principles of Contract Law* 6 ed (2002) 44; D Hutchison "The Nature and Basis of Contract" in D Hutchison & CJ Pretorius(eds) *Law of Contract in South Africa* 3 ed (2017) 4 14.

[378] Bradfield *Law of Contract* 37.

Conradie v Rossouw[379] the court explained that for an agreement to constitute a contract it must be entered into "seriously and deliberately and with the intention that a lawful obligation should be established." Determining the existence or absence of an intention to create legal obligations can be difficult, particularly in cases concerning pre-contractual agreements.[380] The question that arises is whether the parties intended their transaction to be given effect to through a number of contracts or by way of one comprehensive contract embodying all the terms.[381] A pre-contractual agreement could constitute the principal contract (in all but name), a contract to negotiate, or a non-binding agreement outlining the terms of the envisaged transaction.[382] The type of agreement will depend on the intention of the parties,[383] and whether the specific jurisdiction is willing to contractually enforce such agreement.

When examining the application of the *animus contrahendi* requirement to pre-contractual agreements from a comparative perspective it is important to recognise certain differences between the various legal systems. In terms of English and American law the presence of an intention to be bound is not sufficient for a contract to be created.[384] For a valid contract to arise, it is necessary for such an intention to be accompanied by some form of consideration in exchange for a party assuming obligations.[385] This requirement does not exist in South African law and the presence of *animus contrahendi* is sufficient to create a contract.[386] The English law test for determining such intention is an objective one, and if the agreement meets all the other validity requirements it is generally presumed that the parties intended to be legally bound.[387] There is also a rebuttable presumption that business agreements are

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[379] 1919 AD 279 324.

[380] Kerr *Principles* 44.

[381] 62.

[382] TC Homburger & JR Schueller "Letters of Intent – A Trap for the Unwary" (2002) 37 *Real Prop Prob & Tr J* 510 518.

[383] 518.

[384] G Klass "Intent to Contract" (2009) 95 *Va LR* 1437 1438; Peel *Law of Contract* 187.

[385] Klass 2009 *Va LR* 1438; Sharrock *Business Transactions Law* 88; GH Treitel "Consideration" in HG Beale (ed) *Chitty on Contracts I General Principles* (2015) 399, 401; Pannebakker *Letter of Intent* 184-185; Farnsworth *Contracts* 47.

[386] Conradie v Rossouw 1919 AD 279 324; Bradfield *Law of Contract* 108; Sharrock *Business Transactions Law* 88.

[387] Bradgate "Formation of Contract" in *Law of Contract* 466; Peel *Law of Contract* 187.

intended to be legally binding.[388]

South African courts will consider both objective and subjective factors in ascertaining the intention of the parties. [389] The general point of departure in South African law is that parties must express a subjective intention to be bound, but there are often circumstances where parties will be held contractually liable on the basis of the doctrine of quasi-mutual assent, which entails an objective enquiry.[390]

In terms of American law, intent fulfils a crucial function in assessing the extent to which parties will be bound by a pre-contractual agreement.[391] The test for intention is not subjective, but is a factual enquiry requiring inferences to be drawn from the agreement and surrounding circumstances.[392]

The *animus contrahendi* requirement will now be applied to agreements with clauses negating legal liability, agreements to negotiate and inchoate or incomplete agreements. These types of agreements in particular bring the *animus contrahendi* requirement into question because they are uncertain and incomplete or have clauses specifically negating the intention to be bound. The impact that uncertainty or incompleteness and clauses negating liability have on the enforceability of the pre-contractual agreement must therefore be considered.

3 3 1 Agreements with clauses negating liability

As we have seen, the intention to create legal obligations is a pre-requisite to contract formation. It follows therefore that where parties have expressed an intention not to be bound, no contract can come into existence.[393] In chapter 2, the clauses potentially negating legal liability were considered. Where parties include such a clause in their agreement this reflects the opposite intention to that of having the *animus contrahendi*

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[388] Bradgate "Formation of Contract" in *Law of Contract* 466-468.

[389] See e.g. *Gelbuild Contractors CC v Rare Woods South Africa (Pty) Ltd* 2002 1 SA 886 (C) 892-893,895 where the court considered whether there was a meeting of the minds, and evidence of what the parties intended (subjective factors) and the wording and nature of the quote and surrounding circumstances (objective factors).

[390] Van Huyssteen et al *Contract* 22, 37-38; Hutchison "The Nature of Contract" in *Law of Contract* 19.

[391] Pannebakker *Letter of Intent* 184.

[392] GG Gosfield "The Structure and Use of Letters of Intent in Pre-Negotiation Contracts for Prospective Real Estate Transactions" (2003) 38 *Real Prop Prob & Tr J* 100 132.

[393] Peel *Law of Contract* 187; Bradfield *Law of Contract* 106; Sharrock *Business Transactions Law* 87.

and create no more than a moral obligation.[394]

A "subject to contract" clause is one of the clauses potentially negating legal liability.[395] Parties may choose to settle the details of an envisaged transaction in an informal pre-contractual agreement but intend to embody the final agreement in a formal contract; this may be based on the understanding that no contractual obligations will arise until execution of such contract.[396] It can be challenging, however, to determine whether the inclusion of a "subject to contract" clause is indeed intended to indicate such an understanding.[397] For this reason, it is necessary to consider, with reference to the legal position in different jurisdictions, the consequences of making a pre-contractual agreement subject to contract.

3 3 1 1 South African law

In terms of South African law, an agreement made subject to contract will generally not give rise to a binding contract because it indicates that parties do not yet regard the agreement as legally binding.[398] In *Command Protection Services (Gauteng) Pty Ltd t/a Maxi Security v South African Post Office Ltd,*[399] a letter of appointment was made subject to the conclusion of a formal contract and the court concluded that no contract could come into existence until this requirement was met.[400]

In *Novick v Comair Holdings Ltd*[401] the parties concluded a letter that made reference to conclusion of a more comprehensive agreement if necessary. Coleman J explained that in this case the question is whether in the absence of a more comprehensive agreement, "the parties will not be bound as they intend and desire to be".[402] He concluded that while conclusion of a more comprehensive agreement may have been desirable it was not necessary.[403] In *Commissioner, South African*

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[394] Kerr *Principles* 42; Bradfield *Law of Contract* 106; see also *Electronic Building Elements v Huang* 1992 2 SA 382 (W) 387E.

[395] See ch 2 (2 3 1).

[396] Perillo *Corbin on Contracts* 144; Hutchison "The Nature of Contract" in *Law of Contract* 4.

[397] Perillo *Corbin on Contracts* 144.

[398] Hutchison "The Nature of Contract" in *Law of Contract* 4.

[399] 2013 2 SA 133 (SCA) para 21.

[400] Sharrock *Business Transactions Law* 87.

[401] 1979 2 SA 116 (W) 121E-122B.

[402] 134G.

[403] 135A.

Revenue Services v Capstone 557 (Pty)[404] *Ltd* the parties concluded a memorandum of understanding (MOU) outlining the key terms of their transaction. The parties envisaged that this agreement would be superseded by a final written contract, but nonetheless agreed that the MOU gave rise to a binding preliminary contract.[405]

It is possible that parties could make their agreement subject to writing and agree that they will not be legally bound until their agreement has been reduced to writing and signed by both of the parties.[406] In *Goldblatt v Fremantle*,[407] the court explained that whether an agreement made subject to writing gives rise to a valid contract is ultimately a question of construction. There is a presumption that a subject to writing clause is not intended to serve as a "pre-condition" to validity of the contract but rather as evidence or record of the agreement.[408] In cases of uncertainty, the court will consider the language of the agreement, the conduct of the parties and the surrounding circumstances to ascertain the parties' intention.[409]

3 3 1 2 Foreign law

In terms of American law, parties generally have the autonomy to bind themselves contractually in whatever manner they wish, and informal agreements can constitute valid contracts.[410] It is, however, entirely possible that parties wish to maintain their freedom and not to be bound by contractual obligations, notwithstanding the fact that they concluded an informal agreement reflecting consensus on all the details of the envisaged transaction.[411] Parties can maintain their freedom of negotiation, if they clearly express an intention not to be bound.[412]

Whether a pre-contractual agreement subject to a future contract will give rise to a valid contract is wholly dependent upon the intention of the parties.[413] If parties intended to be immediately bound prior to execution of a formal contract, then the

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[404] 2016 4 SA 341 (SCA) para 7.

[405]2016 4 SA 341 (SCA) para 7.

[406] Sharrock *Business Transactions Law* 86.

[407] 1920 AD 123 125-126,129.

[408] *De Bruin v Brink* 1925 OPD 65 70,73.

[409] Para 6.

[410] Perillo *Corbin on Contracts* 145.

[411] 146.

[412] Perillo *Corbin on Contracts* 146; Farnsworth *Contracts* 118.

[413] 146.

informal agreement will constitute a binding contract.[414] Judge Leval in *Tribune Co*[415] classified this agreement as a type I preliminary agreement; execution of a formal contract is desirable, but not necessary for contract formation.[416]

American courts take certain factors into account when determining whether a pre-contractual agreement subject to contract is intended to be binding or provisional and non-binding.[417] For example if the transaction is large and complex there is a greater likelihood that the informal communications and agreements are intended to be provisional and thus not binding.[418] Section 27 of the Restatement (Second) of Contracts lists useful factors that can be applied to determine whether the requisite *animus contrahendi* is present in an agreement subject to contract.[419] New York courts apply a slightly different four-factor test to determine the intent of parties in concluding a pre-contractual agreement.[420] This test is derived from *Winston v Mediafare Entertainment Corporation*[421] ("*Winston*") and requires consideration of the following:

> "(1) whether there has been an express reservation of the right not to be bound in the absence of a writing; (2) whether there has been partial performance of the contract; (3) whether all of the terms of the alleged contract have been agreed upon; and (4) whether the agreement at issue is the type of contract that is usually committed to writing."[422]

The context in which negotiations took place is also significant, and in some cases is considered by a court as a fifth factor, although it often overlaps with other factors.[423] A court considering the context may also look to the language of the agreement, for example, the existence of a condition precedent in a pre-contractual agreement generally indicates the absence of an intention to be bound.[424]

These factors are not individually decisive in ascertaining the intention of the

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[414] 146.

[415] (1987) 670 F Supp 491 (S D N Y) 498.

[416] JE Murray *Murray on Contracts* (2011) 65-66.

[417] Pannebakker *Letter of Intent* 165; Jeffries 2012 *Gonz L Rev* 23.

[418] Perillo *Corbin on Contracts* 152.

[419] 159.

[420] 160.

[421] (1985) 777 F 2d 78 (2d Cir) para 81.

[422] Para 81.

[423] Jeffries 2012 *Gonz L Rev* 1 32.

[424] 32.

parties; rather, each one constitutes a valuable guiding principle.[425] In cases of uncertainty or ambiguity, American courts may rely on the presumption that pre-contractual agreements are not binding.[426] While the "subject to contract" clause is an important factor for determining whether the preliminary agreement gives rise to a contract, it is not conclusive, particularly if the agreement contains other language reflecting an intention to be bound.[427]

American courts will first apply the all or nothing approach to ascertain whether the pre-contractual agreement constitutes a principal contract.[428] If not, the enquiry does not necessarily end here. Courts in some states may go on to consider whether the otherwise non-binding pre-contractual agreement gives rise to other intermediate contractual obligations.[429] Some states recognise that pre-contractual agreements can impose an obligation to negotiate.[430] American courts use the criterion of intent to distinguish whether a pre-contractual agreement gives rise to the principal contract or a contract to negotiate and to identify specific contractual obligations in an otherwise non-binding agreement.[431]

England adopts a similar legal position to South Africa and America regarding clauses negating legal liability.[432] In *Rose and Frank v Crompton Bros Ltd*,[433] for example, the agreement was unenforceable due to such a clause. In terms of English and American law, where an agreement contains all the material terms of the envisaged transaction, very clear language negating legal liability will be required to prevent contract formation.[434] Generally, pre-contractual agreements subject to contract are regarded as non-binding.[435] English courts recognise that the parties' conduct in negotiations, the language of the agreement, and the parties' subsequent

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[425] *RG Group Inc v Horn & Hardart Co* (1984) 751 F 2d 69 (2d Cir) para 75.

[426] Perillo *Corbin on Contracts* 159.

[427] 152-153.

[428] Pannebakker *Letter of Intent* 162.

[429]A Schwartz & RE Scott "Precontractual Liability and Preliminary Agreements" (2007) 120 *Harv L Rev* 661 664; Pannebakker *Letter of Intent* 163-164; See ch 3 (3 2 2 2 (ii)).

[430] 3 2 2 2(ii).

[431] Pannebakker *Letter of Intent* 165; see 3 3 2.

[432] Peel *Law of Contract* 191;

[433] 1923 2 KB (CA).

[434] Bradgate "Formation of Contract" in *Law of Contract* 485; Perillo *Corbin on Contracts* 144.

[435] Bradgate "Formation of Contract" in *Law of Contract* 268; Peel *Law of Contract* 192.

conduct can result in a finding that a subject to contract clause did not prevent contract formation.[436]

3 3 2 Agreements to negotiate

From the preceding section, it is clear that a pre-contractual agreement outlining the terms of the envisaged transaction will not give rise to the principal contract if it contains some clause negating legal liability. Such agreements may still give rise to an obligation to negotiate in good faith.[437] While American courts recognise this possibility,[438] English courts are unlikely to enforce this obligation due to the clause negating legal liability.[439]

The main obstacle to the enforceability of agreements to negotiate is uncertainty (as discussed above). [440] In the English case of *Barbudev v Eurocom Cable Management Bulgaria Eood*[441] the parties intended to be contractually bound by an express obligation to negotiate in good faith, but the agreement was nevertheless unenforceable due to uncertainty. However, in American law this obligation can be sufficiently certain, which still makes it necessary to consider whether there is an intention to be bound. The test for determining such an intention has been dealt with at great length in case law and literature. American courts require express language in the agreement manifesting the intention to create a legally binding undertaking to negotiate in good faith, but also look to the construction of the agreement and the surrounding circumstances.[442]

Courts apply the four-factor test set out in the *Winston* case to determine the

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[436] Peel *Law of Contract* 193-194; see e.g. *RTS Flexible Systems Ltd v Molkerei Alois Múller GmbH & Co KG* [2010] 1 WLR 753 48.

[437] In the American case of *Gas Natural Inc v Iberdrola USA Inc* (2014) *33* F Supp 3d 373 (S D N Y) 380-381 the court concluded that the obligation to negotiate in good faith outweighed the clause negating legal liability.

[438] SD Aaron & J Caterina "Contract Formation under New York Law by Choice or through Inadvertence" (2016) 66 *Syracuse L Rev* 855 860; Blum *Examples* (2017) para 10 6 4; Pannebakker *Letter of Intent* 165; Jeffries 2012 *Gonz L Rev* 20; Klass 2009 *Va L Rev* 1449.

[439] Hoskins 2014 *LQR* 158.

[440] Furmston & Tolhurst *Contract Formation* 317.

[441] [2012] EWCA Civ 548 paras 37-38, 47-53.

[442] PB Quagliato "The Duty to Negotiate in Good Faith" (2008) 50 *IJLMA* 219.

intention to be bound by an obligation to negotiate .[443] In *Tribune Co*, Judge Leval explained that this test, which is generally applied to determine the existence of a final preliminary contract, has to be applied differently to agreements to negotiate.[444] For example, the existence of outstanding terms would usually weigh heavily against a finding that a principal contract had come into existence. However, in the context of an agreement to negotiate, this factor would not weigh as heavily, because the very purpose of such agreement is to bind parties to negotiate those outstanding terms.[445] Furthermore, reference to further approvals may indicate the absence of an intention to enter into the final contract, but it does not necessarily indicate that parties do not intend a contract to negotiate.[446] Courts should be cautious not to impose obligations on the parties which they did not intend.[447]

3 3 3 Inchoate or incomplete agreements

Inchoate or incomplete agreements could record the terms upon which consensus has been reached and facilitate the negotiation of the remaining terms of the envisaged transaction.[448] If the principal contract is not concluded, it is possible that one of the parties will seek enforcement of the inchoate agreement as a valid contract.[449] One main obstacle to an inchoate agreement giving rise to a binding contract is the absence of the *animus contrahendi*.

3 3 3 1 South African Law

Generally, inchoate agreements are intended to be provisional non-binding records of negotiations; the absence of the *animus contrahendi* therefore prevents contractual obligations from arising.[450] However, reference in an incomplete or inchoate agreement to further terms to be negotiated will not necessarily give rise to an

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[443] *Teachers Insurance v Tribune* Co (1987) 670 F Supp 491 (S D N Y) 499; Jeffries *Gonz L Rev* 2012 23.

[444] 670 F Supp 491 (S D N Y) 499.

[445] 499.

[446] 499.

[447] 499.

[448] Bradfield *Law of Contract* 42; Bradgate "Formation of Contract" in *Law of Contract* 265-266.

[449] Bradfield *Law of Contract* 43.

[450] 43.

inference that the agreement was intended to be only provisional or non-binding.[451] The parties could, for example, intend that missing terms would be provided on the basis of what is "usual, or reasonable, or on which there can be no dispute".[452] It is also possible that the parties intended that the rules of the common law would provide the missing terms.[453]

When considering the legal nature of an incomplete agreement, *Pitout v North Cape Livestock Co-operative Ltd*[454] provided that it is necessary to ask the following question:

> "[w]as the undertaking an offer made, *animo contrahendi*, which upon acceptance would give rise to an enforceable contract, or was it merely a proposal made … while the parties were in the process of negotiating and were feeling their way towards a more precise and comprehensive agreement? This is essentially a question to be decided upon the facts of the particular case."

The court concluded that the arrangement in this case was made in the course of incomplete negotiations and did not acquire contractual force, because it was no more than a proposal made during negotiations which if successful would have culminated in a final contract.[455]

Various cases explain the types of circumstances that prevent an incomplete agreement from giving rise to a binding contract. In *Kenilworth Palace investments (Pty) Ltd v Ingala*[456] the parties formulated heads of agreement. Friedman J concluded that the heads of agreement were not capable of "standing on their own".[457] The parties contemplated "that certain other agreements, which were essential to the validity of the heads of agreement, would be in existence when that agreement was signed".[458] An agreement that makes reference to annexures that are not in existence at the time of its conclusion will also not constitute a binding contract; it is inchoate.[459]

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[451] 44.

[452] Bradfield *Law of Contract* 44.

[453] Sharrock *Business Transactions Law* 85.

[454] 1977 4 SA 842 (A) 850D.

[455] 853B-D.

[456] 1984 2 SA 1 (C).

[457] 12H-13A.

[458] 12H-13A.

[459] Bradfield *Law of Contract* 45; see *Ellerines Furnishers (Venda) (Pty) Ltd v Rambuda* 1989 2 SA 874

Parties will lack the *animus contrahendi* if an agreement is concluded solely for purposes of assisting parties in further negotiations.[460] In *OK Bazaars v Bloch,*[461] for example, the court concluded from the evidence before it that an agreement reached in the course of negotiations, outlining the essential terms of a contract of sale, was not binding because parties contemplated that outstanding material terms would be resolved by their respective attorneys and be embodied in a formal contract. In *Titaco Projects (Pty) Ltd v AA Alloy Foundry (Pty) Ltd*[462] the court found that a settlement agreement amounted to no more than a "basic framework for an agreement or an 'agreement in principle'" and that the parties lacked the *animus contrahendi,* because material terms regarding specifications had yet to be negotiated and agreed upon.

An agreement will not give rise to a valid contract if there are material terms outstanding and parties do not intend to be bound until such terms have been agreed upon.[463] Whether outstanding terms are material will be determined with reference to the agreement itself and evidence of the parties' conduct during negotiations and after agreement conclusion.[464] It appears that inessential terms may be left to further negotiation without the validity of the contract being affected.[465]

It is indeed possible for the parties to enter into a binding contract, despite expressly or impliedly leaving important outstanding terms to future negotiation or having agreed to conclude a comprehensive contract in the near future.[466] If consensus is reached on the outstanding matters, the complete contract will supersede the initial contract, but if not, the initial contract will stand.[467]

The court in *CGEE Alsthom* [468] stated that "[w]hether in a particular case the initial agreement acquires contractual force or not depends upon the intention of the parties,

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[460] Sharrock *Business Transactions Law* 84.

[461] 1929 WLD 37 40-41.

[462] 1996 3 SA 320 (W) 333-334.

[463] Sharrock *Business Transactions Law* 84.

[464] 84.

[465] Bradfield *Law of Contract* 44.

[466] Bradfield *Law of Contract* 45; see 2 3 2 3.

[467] *CGEE Alsthom Equipments et Enterprises Electriques, South African Division v GKN Sankey (Pty) Ltd* 1987 1 SA 81 (A) 92C-F; Bradfield *Law of Contract* 45.

[468] 1987 1 SA 81 (A).

which is to be gathered from their conduct, the terms of the agreement and the surrounding circumstances".[469] In this case, the appellants sent a telex to the respondents, informing them that their tender had been accepted.[470] The question is whether in light of all the surrounding circumstances, the acceptance of the tender by telex could give rise to a binding contract.[471]

The court conceded that there were a number of outstanding terms and that a comprehensive contract had yet to be concluded,[472] but emphasised that this does not necessarily deprive an agreement of contractual force.[473] The outstanding terms, which the appellants regarded as important, were a factor weighing heavily against the existence of a contract.[474] There were, however other, compelling factors, namely the unconditional wording of the telex, the surrounding circumstances, and the subsequent conduct of the parties. [475]

Ultimately, the court found that the wording in the telex "we have the pleasure of informing you that the order has been awarded to yourselves", in the circumstances could only be construed as an unqualified acceptance of the offer, thus creating a binding contract.[476]

Thus far the focus was on the need for an *animus contrahendi* in the sense of an actual, subjective intention to be bound. However, sometimes a party may be bound even in the absence of such an intention, due to instruments such as the doctrine of quasi-mutual assent.[477] If one party creates a "reasonable impression in the mind of the other party" that he intends a contract to arise from the agreement, and the latter enters into such agreement on the basis of such impression, a binding contract can be deemed to have arisen.[478]

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[469] 92E.

[470] 83H-I,84F-G.

[471] 92I-93A.

[472] 92F-G.

[473] 92C-D.

[474] 93A-B.

[475] 93B-94E.

[476] 90J-91B, 94E.

[477] Bradfield *Law of Contract* 45; Sharrock *Business Transactions Law* 88; *MV Navigator (no 1): Wellness International Network Ltd v MV Navigator* 2004 5 SA 10 (C) 22G.

[478] Sharrock *Business Transactions Law* 88.

The practical application of the doctrine of quasi-mutual assent to a preliminary agreement is illustrated by *MV Navigator (no 1): Wellness International Network Ltd v MV Navigator.*[479] While there was no subjective meeting of the minds in this case, it still had to be established whether the claimant had been reasonably led to believe that the other party, by an exchange of emails, intended to conclude a contract of sale.[480] The test is an objective one, which takes into account the knowledge that the claimant had and could reasonably have acquired.[481] The court found that due to the nature of the communications, the outstanding terms, and reference to the execution of a formal contract, a reasonable person would not have been misled to believe that the owner intended to be bound by a contract on the basis of email correspondence.[482] This case nonetheless confirms that it is indeed possible for an initial agreement to give rise to a binding contract on the basis of this doctrine.

3 3 3 2 Foreign law

As a point of departure, the American and English legal systems generally also regard incomplete or inchoate agreements to be non-binding. However, an inchoate agreement can sometimes constitute a contract despite important matters having been left to future negotiation.[483] This was confirmed in the English case of *Bear Stearns Bank plc v Forum Global Equity Ltd,*[484] where only the subject matter and price had been agreed upon. Such an agreement could be valid, unless the absence of consensus on outstanding terms renders the agreement uncertain or parties do not intend to be bound until such terms have been agreed upon.[485] In the American case of *Borg-Warner Corp v Anchor Couple Co*[486] the court concluded that a pre-contractual

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[479] 2004 5 SA 10 (C).

[480] 24A-C.

[481] 24C-D.

[482] 25E-G.

[483] Peel *The Law of Contract* 61-63; Bradgate "Formation of Contract" in *Law of Contract* 265-266; Farnsworth *Contracts* 123; see also the American case of *A/S Apothekernes Laboratorium for Specialpraeparater v IMC Chemical Group Inc* 873 F 2d (7th Cir) 155 (1989) 157.

[484] [2007] EWHC 1576.

[485] *Bear Stearns Bank plc v Forum Global Equity Ltd* [2007] EWHC 1576 paras 155, 164 166. See also Bradgate "Formation of Contract" in *Law of Contract* 329; Peel *The Law of Contract* 61-63; Beatson et al *Anson's Law of Contract* 70.

[486] (1958) 16 III (2nd Cir) 234 237-238, 244.

agreement with open terms could constitute a contract binding parties to their original agreement with missing terms being supplied by the court if the parties are unable to agree.[487] The PICC also confirm that if parties intend to conclude a contract, the existence of open terms left to future negotiation will not necessarily prevent contract formation, if there is an alternative mechanism for rendering those terms certain.[488]

3 4 Public policy, and the values of good faith and ubuntu

There is considerable debate over the role of fairness, reasonableness and the value of good faith in the law of contract.[489] For present purposes, the focus will be on the extent to which these values can influence the determination of the validity of pre-contractual agreements. Lewis confirms that these values are regularly relied on as factors in the evaluation of the contractual enforceability of agreements.[490] In fact, she argues that this has to some extent resulted in the importance of other foundational values of contract law, such as certainty in contract, being overlooked.[491] Certainty is of particular importance in commercial dealings.[492] It is a fundamental principle of contract law that parties should observe their agreements unless they are contrary to public policy.[493]

In *Barkhuizen v Napier,*[494] Ngcobo J, delivering judgment for the majority, explained that the constitutionally-recognised values of *ubuntu* and good faith can inform public policy.[495] Hutchison describes good faith as "an ethical value or controlling principle, based on community standards of decency and fairness that underlies and informs substantive contract law".[496] This thesis does not seek to extensively analyse the

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[487] Farnsworth 1987 *Colum LR* 250,253; Pannebakker *Letter of Intent* 162; Nedzel 1997 *Tul Eur & Civ LF* 119-120.

[488] Art 2.1.14(1).

[489] Lewis 2013 *THRHR* 81; Louw 2013 *PER* 44-51; Bhana & Broeders 2014 *THRHR* 168; J Du Plessis "Giving Practical Effect to Good Faith in the Law of Contract" (2018) 18 *Stell LR* 379.

[490] 81.

[491] 81.

[492] 82.

[493] 82.

[494] 2007 5 SA 323 (CC) para 73.

[495] Paras 28, 51,73.

[496] "Non-variation Clauses in Contract: Any Escape from the *Shifren* Straitjacket?" (2001) 118 *SALJ* 720 744.

proper role of the broader value of good faith in the South African law of contract, but this concept will be touched upon insofar as it influences the enforceability of agreements to negotiate.

Public policy may demand the preservation and promotion of good faith and *ubuntu* in contractual relationships, and arguably requires the enforcement of pre-contractual understandings that foster mutual respect and regard for each other's interests, or at the very least requires of parties to abstain from bad faith conduct in the course of negotiations. However, freedom of contract, which includes freedom not to contract and contractual autonomy, is also regarded as one of the fundamental values in the South African contract law.[497] Upholding these values may in turn be necessary to promote commercial growth and efficiency.[498]

The underlying values of good faith and *ubuntu* therefore have to be balanced with the notions of certainty, freedom of contract and party autonomy.[499] This brings into question the validity of certain pre-contractual agreements that potentially undermine legal certainty and deprive parties of their autonomy by limiting their freedom of contract, including the right to terminate negotiations.[500]

In *Walford,*[501] an English case, the court refused to recognise an agreement to negotiate in good faith because it was "inherently repugnant to the adversarial position of the parties when involved in negotiations."[502] Cumberbatch argues that the reluctance of the court to enforce such an agreement was primarily based on public policy, because such an agreement infringes on freedom of contract and party autonomy.[503] Cohen in turn argues that this decision protects "negative freedom from contract", allowing parties to avoid obligations until a final contract has been concluded.[504] Cumberbatch rejects this notion, arguing that the value of freedom of

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[497] Lewis 2013 *THRHR* 84.

[498] Hutchison 2011 *SALJ* 290.

[499] Lewis 2013 *THRHR* 83; *Barkhuizen v Napier* 2007 5 SA 323 (CC) para 28-30; McKerrow 2017 *Stell LR* 326.

[500] Bhana & Broeders 2014 *THRHR* 173; McKerrow 2017 *Stell LR* 326.

[501] [1992] 2 AC 128 129.

[502] 129.

[503] "In Freedom's Cause: The Contract to Negotiate" (1992) 12(4) *Oxford J Legal Stud* 586 587.

[504] "Two Freedoms and the Contract to Negotiate" in D Friedmann & J Beatson (eds) *Good Faith and Fault in Contract Law* (1995) 25 28,54.

contract might actually be better given effect to by holding parties to what they have agreed earlier, rather than by refusing to enforce agreements that the parties intended to be binding.[505]

To force one party to negotiate with another does appear at first sight to be an infringement of contractual freedom and autonomy. Hoskins, an English academic correctly argues that this rationale would only justify a refusal to impose a "legal duty to negotiate in good faith".[506] Beatson, Burrows and Cartwright conclude that unlimited freedom to withdraw is not an essential element of negotiations.[507] If the parties have voluntarily chosen to regulate their negotiations by imposing an obligation to negotiate in good faith, then objection to these types of agreements on the basis of public policy seems less convincing.[508]

The validity of pre-contractual agreements that limit freedom of negotiation needs to be considered in light of the principle of *pacta sunt servanda* in South African contract law.[509] Legal certainty, an important value in commercial contracts in particular, is supported and advanced by this principle.[510] It can be argued that the values of *pacta sunt servanda* and freedom of contract favour the recognition of agreements to negotiate as valid contracts, as long as they are voluntarily concluded with the requisite *animus contrahendi*.[511]

However, Lewis does not agree with this contention, arguing that before this principle can apply it is necessary first to establish whether a *pactum* is in fact at hand.[512] In *Everfresh*[513] the court considered in an obiter dictum whether an agreement to negotiate should constitute a valid *pactum*.

Yacoob J, for the minority, explained that when interpreting a negotiation clause, it is essential to consider public policy and section 39(2) of the Constitution of the Republic of South Africa, 1996 and he proceeded to emphasise that the values of

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[505] 1992 *Oxford J Legal Stud* 587, 589.

[506] 2014 *LQR* 133.

[507] *Anson's Law of Contract* 69.

[508] Cumberbatch 1992 *Oxford J Legal Stud* 589; Hoskins 2014 *LQR* 133;140.

[509] Lewis 2013 *THRHR* 88.

[510] 88.

[511] Bhana & Broeders 2014 *THRHR* 173.

[512] 2013 *THRHR* 88.

[513] 2012 1 SA 256 (CC).

ubuntu, good faith and public policy are also closely interlinked.[514] Yacoob J concluded that:

> "A common-law principle that renders an obligation to negotiate enforceable cannot be said to be inconsistent with the sanctity of contract and the important moral denominator of good faith."[515]

Furthermore,

> "the determination whether a promise is too illusory or too vague and uncertain must be made against the backdrop of an understanding that good faith should be encouraged in contracts and a party should be held to its bargain."[516]

Moseneke DCJ, in an obiter dictum also emphasised the importance of developing the common law in accordance with underlying values of good faith, *ubuntu* and *pacta sunt servanda*.[517] Moseneke DCJ conceded that these values tend to support the development of the common law to recognise agreements to negotiate:[518]

> "Were a court to entertain Everfresh's argument, the underlying notion of good faith in contract law, the maxim of contractual doctrine that agreements seriously entered into should be enforced, and the value of ubuntu, which inspires much of our constitutional compact, may tilt the argument in its favour. Contracting parties certainly need to relate to each other in good faith. Where there is a contractual obligation to negotiate, it would be hardly imaginable that our constitutional values would not require that the negotiation must be done reasonably, with a view to reaching an agreement and in good faith."[519]

It is clear from these obiter statements that the Constitutional Court firstly, envisages a more substantial role for good faith in the South African law of contract,[520] and secondly, that it is receptive to developing the common law to enforce agreements to negotiate.[521] It also supports the movement towards an approach which emphasises "fairness in the pursuit of contractual justice."[522] It is however unfortunate that the court fails to draw a clear distinction between the subjective and objective meanings of good

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[514] Para 26.

[515] Para 36.

[516] Para 37.

[517] Para 70-72.

[518] Para 70.

[519] Para 72.

[520] Louw 2013 *PER* 65-66.

[521] Bhana & Broeders 2014 *THRHR* 168.

[522] 66.

faith in their analysis of agreements to negotiate in good faith. It is also unclear whether the court is supporting the imposition of an overarching obligation to negotiate in good faith or merely confirming that agreements to negotiate should be enforceable and that the value of good faith can be directly relied upon to develop the common law to enforce such agreements. In this thesis the latter interpretation of the *Everfresh* judgment will be adopted.

Lewis criticises *Everfresh*, arguing that it undermines legal certainty regarding "contractual arrangements that are simply not valid".[523] Lewis concedes with reference to the *CGEE Alsthom* case that a valid obligation to agree on outstanding terms of a contract is possible, but emphasises that the agreement to negotiate envisaged in *Everfresh* is simply not a pactum.[524] She argues that there is no general obligation to negotiate in good faith that parties can rely upon, because it is too vague and concludes that for this reason the *Everfresh* judgments "offend the principle of legality and infuse the law of contract with confusion".[525]

Louw, however, correctly points out that this judicial conservatism to maintain legal certainty is inconsistent with the values enshrined in the Constitution and the principle that all contracts are *bone fidei*.[526] Louw explains that this principle establishes "good faith as a criterion in the interpretation of contracts as well as in the evaluation of the parties in performance and antecedent negotiations".

In *Brisley v Drotsky*[527] the court set out the principle that good faith cannot be relied upon as an independent, or a free-floating basis to enforce or set aside contractual terms. Van der Sijde, however, observes that the role of contract law in the regulation of contractual relationships has seen a shift since the advent of the Constitution.[528] This has laid the foundation for the doctrine of good faith to be developed to promote societal values and fairness in contractual negotiations. In *Savage & Lovemore Mining (Pty) Ltd v International Shipping Co Pty Ltd*[529] the court explained *bona fides* in

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[523] 2013 *THRHR* 92.

[524] 89.

[525] 94.

[526] Louw 2013 PER 56-57; *Meskin v Anglo American Corporation of SA Ltd* 1968 4 SA 793 (W) 802A.

[527] 2002 4 SA 1 (SCA) para 22.

[528] *The Role of Good Faith in the South African Law of Contract* LLM thesis, Pretoria University (2012) 30; see also McKerrow 2017 *Stell LR* 328.

[529] 1987 2 SA 149 (W) 198A-B.

contracting extends to "the process of reaching consensus". Therefore "a party who adopts an ambivalent posture with a view to manipulating to his own advantage…has a state of mind that falls short of the requirements of bona fides".[530]

Mupangavanhu, argues that "if good faith is indeed the basis of contracts in South Africa, it is inconsistent with sections 8(3) and 39(2) of the Constitution that good faith still plays a peripheral role in resolving contractual disputes."[531] She concludes that a different outcome in *Everfresh* was possible; the common law of good faith could have been developed to impose an obligation to negotiate in good faith, even in the absence of a deadlock-breaking mechanism.[532]

The pertinent question here is therefore whether the common law can indeed be developed beyond existing precedent to enforce an agreement to negotiate even in the absence of a deadlock-breaking mechanism.[533]

McKerrow suggests that it is possible to "enforce agreements to negotiate in a manner that satisfies the requirements of *pacta sunt servanda*, legal certainty and fairness to the affected parties".[534] Building on the obiter statements made in *Everfresh*, he argues that the underlying value of good faith can be applied to enforce agreements to negotiate and should be interpreted as an objective standard infusing notions of reasonableness.[535] Louw explains that much of the legal uncertainty surrounding good faith is resolved if good faith is understood as an objective value.[536] Public policy as influenced by the objective value of good faith can inform the contractual obligation to negotiate in good faith and to determine whether there has been breach of such obligation.[537] If good faith is interpreted as an objective value, the concerns raised by Lewis regarding legal uncertainty will be minimised.

Everfresh illustrates precisely why the common law requires development. In this case the parties had intended to be bound by an obligation to negotiate in good faith

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[530] 198A-B.

[531] Mupangavanhu 2013 *SJ* 170,173.

[532] 164-170, 167-169, the author also explains why the court had a duty to develop the common-law; see also Bhana & Broeders 2014 *THRHR* 172-173.

[533] Mupangavanhu 2013 *SJ* 158.

[534] 2017 *Stell LR* 326.

[535] 329.

[536] 2013 *PER* 81, 85.

[537] McKerrow 2017 *Stell LR* 330-331.

and such an *animus contrahendi* was "frustrated by a common-law rule that does not yet consider… a duty to negotiate in good faith enforceable, especially in the absence of a deadlock-breaking mechanism".[538] The shortfalls of the common law allowed Shoprite Checkers to escape an obligation that was originally intended to be contractually binding.

The utility of good faith as an underlying value lies in its innate sensitivity to the demands on modern commerce.[539] It thus seems fitting for good faith as an underlying value to help resolve uncertainty of the ever-increasing phenomena of agreements to negotiate. The underlying value of good faith can be relied upon to develop the rules regarding contract formation to recognise the enforceability of agreements to negotiate, even in the absence of a deadlock-breaking mechanism. *Everfresh*[540] and the supporting academic commentary, bolster the conclusion that the value of good faith as informed by *ubuntu* could be applied to develop the legal rules so as to impose an enforceable obligation to negotiate in the context of agreements to agree or negotiate.[541]

3 5 Conclusion

Homburger and Scheuller's classic study of letters of intent in the context of Illinois law describe pre-contractual agreements as "traps for the unwary".[542] There is much uncertainty and controversy both locally and internationally about the legal nature of pre-contractual agreements and this creates an environment in which negotiating parties can either behave opportunistically[543] or be bound by contractual obligations which they never intended to bring into existence. In either case this gives rise to inequitable consequences. Developing certain, but flexible legal rules which provide clarity regarding the contractual nature of different types of pre-contractual agreements is essential to promoting efficient business transactions while maintaining

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[538] Mupangavanhu 2013 *SJ* 167.

[539] L Hawthorne "The 'New Learning' and Transformation of Contract Law: Reconciling the Rule of Law with the Constitutional Imperative to Social Transformation" (2008) 23 *SAPL* 77 86.

[540] 2012 1 SA 256 (CC) paras 37-38, 69, 72, 78.

[541] McKerrow 2017 *Stell LR* 335; Bhana & Broeders 2014 *THRHR* 175; Schoeman *Agreements to Agree* 31; see 3 2 2 1

[542] 2002 Real Prop Prob & Tr J 510.

[543] See discussion in ch 2 (2.5).

legal certainty in the law of contract.

It was indicated that different legal systems adopt different approaches to the regulation of the various types of pre-contractual agreements, but all accept that the name given to the agreement does not determine its contractual nature. Thus, agreements erroneously labelled as pre-contractual agreements can constitute binding principal contracts if they meet the requirements of certainty and *animus contrahendi*, notwithstanding outstanding terms or clauses negating liability.[544] Save for those agreements falling into the aforementioned category, the South African and English legal systems remain relatively conservative in their approach to pre-contractual agreements. In particular, agreements to negotiate are regarded as unenforceable, unless the obligation to negotiate forms part of a pre-existing contract or contains a deadlock-breaking mechanism. American law by contrast has seen some recent development in relation to pre-contractual agreements. It was observed that the grey area common to each of the jurisdictions under consideration is in the legal nature of preliminary agreements that are intended to impose contractual obligations, but do not contain a deadlock-breaking mechanism and have outstanding terms to be negotiated in good faith.[545] These agreements can give rise to one of two possible contractual obligations: They could either bind parties to the final contract (or to conclude the final contract) or bind parties to negotiate in good faith towards conclusion of the final contract. Some American states have recognised the enforceability of both types of contractual obligations.

The question that remains to be answered is whether an obligation to negotiate in good faith can meet the validity requirements in terms of South African law. South African contract law, as it stands, requires that a negotiation clause forms part of a binding preliminary agreement and that it should have a deadlock-breaking mechanism to be valid and enforceable.[546] This excludes the enforceability of the two types of agreements falling in the grey area. With the benefit of comparative analysis, it can be argued that South African contract law has reached a stage where development to recognise other types of agreements to negotiate (or agreements to agree) is both necessary and possible, particularly if our law is to promote the values

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[544] See ch 3 (3 3 1 & 3 3 3).

[545] Hutchison 2011 *SALJ* 274.

[546] See ch 3 (3 2 2 1).

enshrined in the Constitution and is to be harmonised with the legal position in foreign jurisdictions.[547]

It is proposed that two types of agreements to negotiate can potentially be recognised in South African law as valid and enforceable with different legal consequences and remedies. First, if an agreement containing a negotiation clause outlines most of the terms of the principal contract and it is intended to give rise to contractual obligations, it can be argued that South African law can be further developed to recognise enforceability of the clause even in the absence of a deadlock-breaking mechanism. In terms of English law the possibility of enforcing a negotiation clause in a pre-existing contract, even in the absence of a deadlock-breaking mechanism, was recognised because the outstanding term could be determined by the court.[548] As Hutchison argues, as long as a negotiation clause forms part of a binding preliminary agreement and open terms are ascertainable with reference to an external standard, they should be enforceable.[549] Based on the sentiments expressed in *Indwe* and by McKerrow[550] and Hutchison,[551] courts could also potentially perform a deadlock-breaking function and such power would be restrained by good faith and reasonableness.

Drawing on the legal position in some American jurisdictions and the obiter views expressed in *Everfresh*[552] it can be argued that South African law can be further developed to potentially recognise a second type of agreement to negotiate that imposes a contractual obligation on the parties to negotiate the principal contract or the remaining terms thereof in good faith, but which does not guarantee the materialisation of such a contract.[553] As long as parties have negotiated in good faith their obligations will be discharged even if no principal contract is concluded.[554]

Concerns regarding uncertainty of the obligation to negotiate in good faith have been considered. It is proposed that these uncertainties can be addressed and

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[547] 2017 *Stell LR* 308, 334-335.

[548] *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2005] EWCA Civ 891 paras 117-118.

[549] 2011 *SALJ* 282.

[550] 2017 *Stell LR* 315.

[551] 2011 *SALJ* 282.

[552] 2012 1 SA 256 (CC) paras 72 78.

[553] McKerrow 2017 *Stell LR* 310,331.

[554] 310, 331; see also 3 2 2 1 & 3 5.

overcome. This proposition is supported by the obiter dictum statements in *Everfresh*[555] and by academics who suggest that the doctrine of good faith as an objective value could be applied to develop the rules of contract to enforce this type of agreement to negotiate in good faith.[556] By drawing a distinction between these two types of agreements to negotiate, courts could avoid uncertainty in relation to the terms of the final contract where there is no deadlock-breaking mechanism or means of determining outstanding terms, but also give effect to the underlying values of good faith and *ubuntu* by enforcing agreements that are intended to impose upon the parties an obligation to comply with a certain standard of conduct in the course of negotiations. The prospects of successfully enforcing this type of agreement is illustrated by American case law.[557]

[555] 2012 1 SA 256 (CC) paras 72 78.

[556] See ch 3 (3 2 2 1 & 3 5).

[557] See ch 3 (3 2 2 2 (ii)).

Chapter 4: The consequences of pre-contractual agreements

4 1 Introduction

In the preceding chapter, it was indicated how pre-contractual agreements that meet certain requirements for validity can give rise to contractual obligations prior to the conclusion of the principal contract. This chapter considers the main contractual obligations potentially arising from pre-contractual agreements, namely negotiating in good faith, and maintaining confidentiality and exclusivity. The focus is especially on the legal consequences of these obligations and the remedies they potentially give rise to in the event that they are breached.

This is a complex issue; courts have been hesitant to enforce pre-contractual agreements and more specifically the obligation to negotiate in good faith precisely because of the difficulty of constructing remedies.[1] These difficulties exist because this area of law is relatively undeveloped.[2] South African and English law have only recognised agreements to negotiate to a very limited extent. As indicated earlier, some states in America have recognised that these agreements are enforceable, but parties often choose to settle out of court.[3] Furthermore courts still tend to apply an "all or nothing approach" to contract formation.[4] Therefore, the question of remedies for

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[1] MA Eisenberg *Foundational Principles of Contract Law* (2018) 514; MK Johnson "Enforceability of Precontractual Agreements in Illinois - The Need for a Middle Ground" (1993) 68 *Chi-Kent L Rev* 939 948-949; EA Farnsworth "Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 *Colum LR* 217 267; HL Temkin "When Does the 'Fat Lady' Sing? an Analysis of 'Agreements in Principle' in Corporate Acquisitions" (1986) 55 *Fordham L Rev* 125 153; CL Knapp "Enforcing the Contract to Bargain" (1969) 44 *NYU L Rev* 673 694; NE Nedzel "A Comparative Study of Good Faith, Fair Dealing and Precontractual Liability" (1997) 12 *Tul Eur & Civ LF* 97 121,147; JCC Sanders "Looking for Faith in all the Wrong Places: Rethinking Agreements to Negotiate in Good Faith" (2006) 7 *UC Davis Bus LJ* 199 230; see also the English case of *Courtney & Fairbairn v Tolaini Bros (Hotels) Ltd* [1975] 1 WLR 297 301; LE Trakman & K Sharma "The Binding Force of Agreements to Negotiate in Good Faith" (2014) 73 *CLJ* 598 604; E Peel "Agreements to Negotiate in Good Faith" in A Burrows & E Peel (eds) *Contract Formation and Parties* (2010) 36 56.

[2] Temkin 1986 *Fordham L Rev* 162.

[3] 162.

[4] 162.

breach of an obligation to negotiate has rarely been judicially addressed until recently.[5]

Agreements to negotiate do not have a set content. Some contain terms of the envisaged transaction in varying levels of detail, while others will solely record an arrangement to negotiate a contract in the future. Identifying remedies for breach of an obligation to negotiate in good faith is therefore particularly difficult. The contractual remedies for breach will ultimately depend on the type of agreement and the jurisdiction in question. For example, the consequences and remedies for breach of an obligation to negotiate will differ depending on whether the obligation arises from an independent agreement to negotiate or an agreement that is intended to be legally binding but has open terms that have been left to future negotiation. The United States of America, South Africa and England treat the enforceability of these agreements differently and this influences the consequences flowing from these agreements (if any).

This chapter will analyse and critically evaluate the potential remedies for breach of enforceable agreements to negotiate, and propose remedies for other types of agreements to negotiate that may be enforceable in South Africa in the future. This assessment will focus on specific performance as the primary remedy for breach of contract in South Africa.[6] The utility of comparative analysis in this regard is limited by the fact that jurisdictions such as America that enforce agreements to negotiate regard damages as the primary remedy for breach.[7] Such analysis will however be useful when considering damages as an alternative remedy in South Africa for breach of these obligations.

While the focus of this chapter will be on remedies for breach of the obligation to negotiate, there are also other important obligations that can arise in the course of contract negotiations. The contractual obligations to maintain confidentiality and exclusivity will be considered as practical examples of provisions that are commonly included in pre-contractual agreements, and the remedies for breach of these obligations will also be analysed.

It is acknowledged that an enquiry into the legal consequences that flow from

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[5] 162.

[6] A Hutchison “Agreements to Agree: Can There Ever be an Enforceable Duty to Negotiate in Good Faith?” (2011) 128 *SALJ* 273 295.

[7] See ch 4 (4 2 2).

breach of contractual obligations regulating the course of negotiations is based on the assumption that breach has or will give rise to legal action.[8] In practice however, there are significant commercial risks in instituting legal action against the other party.[9] Therefore the last part of this chapter will discuss extra-judicial consequences that promote compliance with pre-contractual agreements.

4 2 Remedies for breach of a duty to negotiate in good faith

As previously discussed in chapter three, a contractual obligation to negotiate may be contained in a preliminary agreement that is intended to be immediately binding, but contains open terms that have been left to future negotiation.[10] Alternatively the negotiation obligation may form part of an independent agreement to negotiate which may outline some of main terms of the envisaged transaction or solely record an arrangement to negotiate a principal contract in the future. Parties to the latter type of agreement are not bound to their ultimate contractual objective; parties are merely bound to negotiate in good faith. It is clear that these two types of agreements to negotiate are intended to perform distinct functions and should thus give rise to different legal consequences and remedies. The investigation of the potential remedies for breach of the obligation to negotiate will focus strongly on American law where both these types of agreements have been enforced.[11]

International instruments such as the UNIDROIT Principles of International Commercial Contracts ("PICC") are also relevant insofar as they deal with remedies for breach of a contractual obligation to negotiate. Article 2.1.15 of the PICC confirms that remedies for bad faith conduct in negotiations is generally limited to reliance damages,[12] however where parties have concluded an express agreement to negotiate,[13] the "full spectrum of remedies" are available for breach.[14] This includes

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[8] M Fontaine & F De Ly *Drafting International Contracts: An Analysis of Contract Clauses* (2009) 53; see also ch 3.

[9] See ch 4 (4 5).

[10] See ch 3 (3 2 2 2); Hutchison 2011 *SALJ* 274.

[11] VS Foreman "Non-Binding Preliminary Agreements: The Duty to Negotiate in Good Faith and the Award of Expectation Damages" (2014) 72 *U Toronto Fac L Rev* 12 21.

[12] Art 2.1.15 read with comment 2.

[13] Art 2.1.15 read with comment 3.

[14] Art 2.1.15 read with comment 3.

an order compelling parties to negotiate, and damages reflecting the positive or negative interest depending upon the extent to which the requirements for such remedy can be demonstrated.[15] This provision is relevant insofar as it can inform development of national law.

Thus far, foreign legal systems that have recognised the obligation to negotiate in good faith have been conservative regarding remedies, because the content of such an obligation is uncertain and controversial.[16] It is difficult for a court to assess what the outcome of negotiations would have been, whether a final contract would have been concluded and, if so, on what terms.[17]

Remedies typically include, but are not limited to specific performance in the form of an order compelling parties to negotiate or damages measured by the reliance interest.[18] The following discussion of specific performance is not limited to an order compelling parties to negotiate, but also considers the possibility of a court or arbitrator determining outstanding terms and enforcing the principal contract.

4 2 1 Specific performance

Specific performance, as previously mentioned, constitutes the primary remedy for breach of contract in South African law[19] and will therefore be considered as the first potential remedy for breach of an obligation to negotiate in good faith. Contracts to negotiate, due to their "peculiar nature", give rise to two potential types of specific performance.[20] Firstly specific performance in this context can consist of an order compelling parties to comply with the obligation to negotiate further in good faith, or secondly specific performance can consist of an order to perform the obligations arising from the envisaged principal contract under negotiation.[21] In respect of the latter type of specific performance, the court will essentially be enforcing the principal

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[15] Art 2.1.15 read with comment 3.

[16] E Pannebakker *Letter of Intent in International Contracting* LLD thesis Eramus University Rotterdam (2016) 194; B Jeffries "Preliminary Negotiations or Binding Obligations: A Framework for Determining the intent of the Parties" (2012) 48 *Gonz L Rev* 1 17.

[17] Pannebakker *Letter of Intent* 194; Farnsworth 1987 *Colum LR* 267.

[18] Jeffries 2012 Gonz *L Rev* 17.

[19] LF Van Huyssteen, GF Lubbe & MFB Reinecke *Contract: General Principles* 5 ed (2016) 366.

[20] Knapp 1969 *NYU L Rev* 725.

[21] Pannebakker *Letter of Intent* 230; Knapp 1969 *NYU L Rev* 725.

contract that formed the subject matter of the negotiation clause, with the court or an arbitrator determining the outstanding terms.[22]

Whether a court can order parties to conclude the envisaged principal contract that contained outstanding term(s) still under negotiation is particularly controversial.[23] Although this type of specific performance is far more extreme and invasive than an interdict, both types of specific performance must be critically evaluated and analysed for purposes of establishing a remedy most fitting to the South African legal system.

4 2 1 1 Order compelling parties to negotiate in good faith

An order compelling parties to negotiate in good faith is probably the most appropriate form of specific performance for breach of an agreement to negotiate, particularly where such agreement solely imposes an obligation to negotiate the main contract in the future. However this type of specific performance is often regarded as an impractical remedy for breach of a negotiation obligation because the relationship between the parties has probably broken down and the parties are estranged.[24] While it is theoretically possible for courts to order parties to comply with their negotiation obligation and subsequently determine compliance with such order, it is doubtful whether the outcome will fulfil the expectations of the aggrieved party.[25]

It is for this very reason that French courts do not award specific performance in the form of "forced negotiation" in this context.[26] Even legal systems that do award specific performance as the primary remedy regard an order compelling parties to negotiate as problematic, because it is difficult to force a party to cooperate and resume negotiations that have already broken down.[27] A claim for specific performance therefore has little prospects of success.[28]

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[22] Pannebakker *Letter of Intent* 230.

[23] Fontaine & De Ly *Drafting International Contracts* 48.

[24] Knapp 1969 *NYU L Rev* 725; RD Mckerrow "Agreements to Negotiate: A Contemporary Analysis" (2017) 28 *Stell LR* 308 322-323. 331; Trakman & Sharma 2014 *CLJ* 624-625; C Lewis "The Uneven Journey to Uncertainty in Contract" (2013) 76 *THRHR* 80 81-87.

[25] McKerrow 2017 *Stell LR* 331.

[26] Nedzel 1997 Tul *Eur & Civ L* 147.

[27] Fontaine & De Ly *Drafting International Contracts* 48.

[28] Nedzel 1997 Tul *Eur & Civ L* 147; RJP Kottenhagen "Freedom of Contract to Forcing Parties into Agreement: The consequences of Breaking off Negotiations in Different Legal Systems" (2006) 12 *Ius Gentium* 61 73.

The application and efficiency of this remedy will firstly be considered in the context of agreements to negotiate that contain a deadlock-breaking mechanism and are consequently enforceable in South Africa. Where such a mechanism is present, South African courts have been willing to grant an order compelling parties to negotiate in good faith as a remedy for breach of a negotiation obligation.[29] The practical application of this remedy will be considered with reference to *Makate v Vodacom (Pty) Ltd* (*"Makate"*).[30]

In *Makate*[31] the parties concluded an agreement to negotiate in good faith the compensation that should be paid to Makate for his "please call me" idea, which was used by Vodacom to develop a new product. It was agreed that if the parties failed to reach agreement on the amount payable, the CEO of Vodacom would determine such amount.[32]

The court ordered Vodacom to negotiate in good faith with Makate to determine "a reasonable compensation payable to him in terms of the agreement."[33] The court recognised determination by the CEO as a valid deadlock-breaking mechanism as long as the CEO did not represent Vodacom in negotiations.[34] If, despite good faith negotiations, the parties failed to reach agreement on the reasonable compensation that should be paid in terms of the agreement, the deadlock-breaking mechanism must be invoked.[35]

However, whether determination by the CEO should constitute a valid deadlock-breaking mechanism is debatable because of the close relationship that exists between the CEO and Vodacom as a party to negotiations. The court is arguably leaving determination of the appropriate compensation to Vodacom. Generally, the presence of a deadlock-breaking mechanism makes it easier to enforce the obligation to negotiate because parties know if they fail to agree that the court may invoke the

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[29] See *Southernport Developments (Pty) Ltd v Transnet Ltd* 2005 2 SA 202 (SCA) paras 4, 17-18, where the court directed parties to negotiate in good faith and that disputes be referred to the arbitrator; *Makate v Vodacom (Pty) Ltd* 2016 4 SA 121 (CC); Hutchison 2011 *SALJ* 294-295.

[30] 2016 4 SA 121 (CC).

[31] Para 5.

[32] Para 5.

[33] Para 107.

[34] Paras 101,103.

[35] Paras 101,103.

deadlock-breaking mechanism. This creates an incentive for parties to comply with an order to negotiate in good faith because there are consequences attached to deadlock. Parties are motivated to negotiate seriously in attempt to reach consensus because the outcome is more likely to be preferable to them than determination by an arbitrator or other deadlock-breaker.[36] In *Makate* however the incentive to negotiate seriously is absent because Vodacom knows that it has a close relationship with the deadlock-breaker.

If a party breaches an agreement to negotiate by attempting to conclude the envisaged transaction with a third party it may also be possible for the court to grant an interdict prohibiting such party from doing so.[37] In *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd*,[38] for example, the court granted an interim interdict prohibiting the conclusion of the envisaged transaction with a third party.

In some European legal systems it may be possible to compel the party in breach to continue negotiations by issuing a formal warning that failure to comply will result in a judicial penalty.[39] Even so, an order compelling parties to negotiate in good faith, in the absence of a deadlock-breaking mechanism, is ultimately unlikely to achieve the result that may be desired by the aggrieved party, which is conclusion of the envisaged contract under negotiation.

If an agreement to negotiate is enforceable even in the absence of a deadlock-breaking mechanism, it is likely that an aggrieved party will at the very least be entitled to an interdict for breach of the obligation to negotiate.[40] In this regard, we can draw a parallel with remedies for breach of a pre-emption contract. Pre-emption contracts, like agreements to negotiate, do not guarantee conclusion of the principal contract, but merely increase the likelihood of its conclusion. Bhana, in her discussion of remedies for breach of a pre-emption contract, explains that a grantee or holder of a pre-emption right may claim specific performance, in the form of a interdict preventing

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[36] See the similar sentiment expressed in respect of a court or jury performing this function in Eisenberg *Principles of Contract Law* 518.

[37] N Thokozani *Pre-Contractual Liability: The Enforceability of Agreements to Negotiate* LLM thesis, University of Kwazulu-Natal (2016) 45.

[38] 2012 6 SA 96 (WCC) para 43.

[39] Fontaine & De Ly *Drafting International Contracts* 49; see article 7.2.4 of the PICC.

[40] Bhana et al *Student's Guide* 101.

the grantor of the pre-emption right from "frustrating the grantee's right of pre-emption".[41] However, it can be argued that the imposition of other significant consequences for the failure to comply appears to be necessary for the efficacy of an otherwise "toothless"[42] obligation. In making this argument it is important to concede that an order compelling parties to negotiate is not totally meaningless and can at the very least oblige negotiating parties to go through the motions of negotiating, even if it does not necessarily guarantee a successful outcome. The next aspect to address is whether specific performance can, in the case of certain agreements to negotiate, entail enforcement of the principal contract under negotiation.

4 2 1 2 Fleshing out terms and enforcement of the principal contract

Specific performance in the form of a court fleshing out terms and enforcement of the principal contract can be problematic. As in most cases the obligation to negotiate regulates the process rather than the outcome of negotiations.[43] Moss explains that if negotiation clauses regulated the outcome of negotiations it would be easier to grant specific performance of the final contract, but because they regulate the process, forcing parties to cooperate to reach consensus would be inappropriate.[44] Bhana explains in the context of pre-emption contracts, that specific performance of contracts which "contemplate co-operation between the parties" gives rise to greater difficulties than specific enforcement of classical contracts.[45] Specific performance seems impossible if there is uncertainty regarding outstanding terms and whether the final contract will even materialise.[46]

There are nevertheless academics that argue that specific performance in the form of the court fleshing out the terms of the envisaged transaction or appointing an arbitrator to do so should be available for breach of an agreement that is similar in

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[41] D Bhana "The Enforcement of Pre-Emption: A Proposed New Form of Specific Performance" (2010) 73 *THRHR* 288 296.

[42] See Hutchison 2012 *SALJ* 294.

[43] GC Moss *International Commercial Contracts: Applicable Sources and Enforceability* (2014) 98; Fontaine & De Ly *Drafting International Contracts* 48; Bhana et al *Student's Guide* 101; see also discussion in Van Huyssteen et al *Contract* 222.

[44] *International Commercial Contracts* 98; Fontaine & De Ly *Drafting International Contracts* 48.

[45] Bhana 2010 *THRHR* 296.

[46] Farnsworth 1987 *Colum LR* 217.

construction to a so-called "agreement with open terms" in American law.[47] These arguments will now be evaluated.

(i) Court determining outstanding terms

Some academics have questioned whether it may be possible for the court to perform the role of deadlock-breaker to determine the outstanding terms in order to finalise the principal contract as a remedy for breach of a negotiation obligation.[48] To grant specific performance in this situation would essentially be to enforce an agreement to agree and requires of the court to predict whether consensus would have been reached on outstanding terms, had the parties negotiated in good faith, and to then fill in those outstanding terms.[49] The availability of this drastic remedy will ultimately depend on the type of agreement to negotiate that has been breached.

As a point of departure, this remedy should not be available for breach of an independent agreement to negotiate the second (main) contract in the future, which does not outline any substantive terms of the future contract.[50] Courts have emphasised that they will not make a contract for the parties.[51] Moss correctly points out that parties to most types of agreements to negotiate are not making a final offer but "following the respective strategic lines towards a complex meeting of the minds" and ultimately the final terms that will be acceptable to both parties are not known until negotiations are complete.[52] Specific performance that speculates regarding the outcome of negotiations before parties have concluded their negotiations would be inconsistent with the purpose of such negotiations.[53]

Fontaine and De Ly argue that specific performance in the form of a judicial determination of terms should generally not be available as a remedy for breach of an obligation to negotiate in a pre-contractual agreement because "a contract can only

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[47] See ch 4 (4 2 2 2(i)), see also Hutchison 2012 *SALJ* 274.

[48] McKerrow 2018 *Stell LR* 331-333; Hutchison 2012 *SALJ* 282*;* Knapp 1969 *NYU L Rev* 725; Fontaine & De Ly *Drafting International Contracts* 49.

[49] See the discussion on the difficulties in awarding expectation damages which similarly apply in the context of specific performance.

[50] Bhana et al *Student's Guide* 101.

[51] 101.

[52] *International Commercial Contracts* 99.

[53] 99.

result from the mutual agreement of the parties and a judge cannot substitute for this".[54]

This is a satisfactory conclusion when dealing with independent agreements to negotiate, but what about agreements recording consensus on the main elements of the contract, which are intended to be binding?[55] Can the court in these circumstances perform the role of deadlock-breaker to determine the outstanding terms of the principal contract?[56]

It is possible that parties have left outstanding terms to future negotiation. In South African law, such an agreement may be enforced if it is clear that the parties intended to be bound notwithstanding outstanding terms - the original contract will prevail if consensus is not reached on the outstanding elements.[57] It can be inferred that in these circumstances, the original agreement must be sufficiently certain to be capable of enforcement. This in turn suggests that outstanding terms would have to be of a secondary or subsidiary nature. This stands in contrast to the approach of systems like Swiss law, where the agreement will also be enforced, but in the event of deadlock the judge will determine the outstanding terms.[58]

The legal position is more complex and uncertain when the agreement to negotiate records consensus on the main terms of the contract, but some material or essential term(s) have been left to future negotiation.[59] Assuming that these agreements do give rise to a binding negotiation obligation, the question is whether breach of such an obligation can give rise to this type of specific performance.

(a) Observations from American law and English law

Some American states have been willing to enforce a so-called agreement with open terms.[60] An agreement with open terms is a binding preliminary contract that outlines most of the terms of the envisaged transaction, but parties have left terms such as the

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[54] *Drafting International Contracts* 49.

[55] 49.

[56] 49.

[57] *CGEE Alsthom Equipments et Enterprises Electriques, South African Division v GKN Sankey (Pty) Ltd* 1987 1 SA 81 (A) 92C-F.

[58] Fontaine & De Ly *Drafting International Contracts* 49.

[59] 49.

[60] Nedzel 1997 *Tul Eur & Civ L* 119.

rental price to future negotiation.[61] If parties intended for the principal contract to come into existence, the contract will not fail for uncertainty as long as "there is a reasonably certain basis for giving an appropriate remedy".[62] Nedzel explains that courts will generally "fill in" outstanding terms if it is "reasonable to do so", and if not, they will grant another appropriate contractual remedy.[63] While it is not uncommon for American courts to flesh out or fill in agreements with open terms, such a remedy is not necessarily desirable because of the element of speculation.[64]

In *Stanford Hotels Corporation v Potomac Creek Associates*[65] the court noted in an obiter statement that specific performance may even be available for breach of type II preliminary agreements. As explained in chapter 3, these agreements bind parties to negotiate in good faith towards conclusion of the principal contract but do not oblige them to ultimately conclude such contract. [66] The court was careful to qualify such statement, explaining that specific performance would only be available if the parties had negotiated in good faith to reach consensus on outstanding terms, and the other party subsequently refuses in bad faith to finalise the contract.[67] The court is then merely enforcing the obligation on terms already undertaken by the parties.[68] If, however, parties failed to reach agreement on outstanding terms, specific performance would not be available.[69] There is no American case law where the court has actually granted specific performance in the form of an injunction compelling parties to negotiate or conclude the envisaged transaction for breach of this agreement to negotiate.[70] In America, the prevailing opinion appears to be that specific

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[61] NE Choi "Contracts with Open or Missing Terms Under the Uniform Commercial Code and the Common Law: A Proposal for Unifications" (2003) 103 *Colum LR* 50 50-51.

[62] 51.

[63] 1997 *Tul Eur & Civ L* 119. Sanders 2006 *UC Davis Bus LJ* 228 explains that expectation damages may be appropriate if courts are unable to fill outstanding terms.

[64] Foreman 2014 *U Toronto Fac L Rev* 30.

[65] (2011) 18 A 3d 725 (DC Cir App) 743 737.

[66] 3 2 2 1 (ii); *Teachers Insurance and Annuity Association of America v Tribune Co* (1987) 670 F Supp 491 (S D N Y) 499.

[67] 743 737.

[68] 737

[69] 737.

[70] Kottenhagen 2006 *Ius Gentium* 73.

performance is an unrealistic remedy for breach in these circumstances.[71]

In English law, breach of a negotiation clause in a pre-existing contract can potentially result in a court determining an outstanding term. In *Petromec Inc v Petroleo Brasileiro SA Petrobras*[72] ("*Petromec*") the court found that in the event that parties were unable to reach agreement on an outstanding term (reasonable costs of upgrade), the court could ascertain such term.[73] There is little difficulty in predicting what the probable outcome of good faith negotiations would be.[74] However it must be noted that the reasonable costs of upgrade is arguably a subsidiary rather than material outstanding term.

(b) Position in South African law and potential development

There are proposals in South African literature regarding the enforceability[75] and legal consequences of agreements to negotiate that do not contain deadlock-breaking mechanisms. Some South African academics argue that breach of the obligation to negotiate may in certain circumstances justify enforcement of the principal contract.[76] They suggest that in the event of breach, courts can give "content to the final contract envisaged by the parties in their preliminary agreement".[77]

Hutchison, for example, argues that an obligation to negotiate in good faith is only enforceable if it forms part of a binding preliminary agreement "which imposes upon them [the parties] a set of contractual obligations" but leaves certain open terms to be fleshed out in the future.[78] He suggests that a court should as an "optional power" be able to determine outstanding terms of the principal contract in the event of breach of an obligation to negotiate because it "would achieve for the parties what failed negotiations should have resulted in".[79] He concedes that a court needs to be careful not to impose "an entirely new contract on the parties" but he nevertheless argues that

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[71] Kottenhagen 2006 *Ius Gentium* 73.

[72] [2005] EWCA Civ 891 para 117.

[73] Para 117.

[74] Paras 117-118.

[75] See ch 3 (3 2 2 2).

[76] Hutchison 2011 *SALJ* 279,282; McKerrow 2017 *Stell LR* 331-332.

[77] McKerrow 2017 *Stell LR* 331-332; see also ch 3 (3 2 2 2).

[78] For further discussion on this type of agreement see ch 3 (3 2 2 2); Hutchison 2011 *SALJ* 274.

[79] Hutchison 2011 *SALJ* 282.

it should theoretically be possible for the court to exercise a deadlock-breaking function and determine, for example, a market-related rental or sale price based on what is objectively reasonable.[80]

Where parties do not mention anything specific about the price, the market-related price can indeed be implied.[81] However, agreements to negotiate specifically provide that parties agree to negotiate regarding the open terms. In these circumstances it seems unlikely that a court will be willing to imply and determine a market-related price to fill in an outstanding term as a remedy for breach of the obligation to negotiate. Parties have not expressly agreed to such an external standard or an "objectively reasonable determination" by the court to determine the open terms in the event that the parties fail to agree

In *H Merks & Co (Pty) Ltd v the B-M Group (Pty) Ltd*[82] a clause in the agreement provided that price adjustments were to be determined "by the parties agreeing thereto".[83] One party argued that a reasonable price adjustment could be implied into the agreement. The court rejected this argument, concluding that the machinery provided for determination of the price adjustment was the agreement by the parties and that a court will not "substitute its own machinery in the form of a reasonable price" for the machinery provided by the parties even if their machinery fails.[84] In a similar vein it can be argued that when a party has breached a negotiation obligation forming part of an incomplete agreement, a court cannot as a remedy for breach, substitute its "own machinery" to perform a deadlock-breaking function. A court will only be able to perform such a function if it can be inferred from the facts that the parties intended, in the event of their failure to agree, that open term(s) would be determined by a court or arbitrator based on what is objectively reasonable.

McKerrow, like Hutchison, argues that this type of specific performance is a potential remedy for breach of a duty to negotiate.[85] According to him, a court will be able to fill in outstanding terms as a remedy for breach of such a duty if it can derive

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[80] Hutchison 2011 *SALJ* 279, 282.

[81] G Bradfield & K Lehmann *Principles of the Law of Sale and Lease* 3 ed (2013) 31-32.

[82] 1996 2 SA 225 (A) 235 B-C, 235C-D.

[83] 235B-D.

[84] 235 B-C, 235C-D.

[85] 2017 *Stell LR* 331-333.

some form of "guiding standard" from the contract to negotiate that can be applied to "construct the final contract" as intended by the parties.[86] He explains that this standard or framework can be internal or external "but must necessarily be imposed by the parties themselves". In the absence of this contractual framework or structure, there will be "no contractual bones to flesh out" and courts would in effect be displacing the parties' autonomy by making a final contract for them.[87]

To this end, the principles set out in *Southernport Developments (Pty) Ltd v Transnet Ltd*[88] ("*Southernport*"), with regard to an arbitrator performing the role of deadlock-breaker can be extended to courts performing such function.[89] These principles can be expressed as follows. Firstly, there would have to be an agreement that is intended to be immediately binding. Secondly, the court should not be making a contract for the parties, but merely be fleshing out terms of an agreement that they have already concluded.[90] This proposed approach is consistent with the views expressed by Hoskins in the context of English law. [91]

McKerrow does not clarify whether the outstanding terms may be material or essential or whether this specific performance is limited to agreements to negotiate where outstanding terms are secondary. In the *Southernport*[92] case, which is referred to as authority,[93] all essential elements had been agreed upon and outstanding terms were subsidiary.

McKerrow also does not give practical examples of what constitutes a "guiding standard" or framework for determining the final contract. It however appears that the parties would need to provide the court with some form of "machinery" for constructing the final contract such as a reference to a "readily ascertainable external standard". The "machinery" must have been expressly or implicitly provided by the parties in lieu of a deadlock-breaking mechanism (such as an arbitration clause).

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[86] 333.

[87] 333.

[88] 2005 2 SA 202 (SCA) Para 17.

[89] McKerrow 2017 *Stell LR* 332-333.

[90] *Southernport Developments (Pty) Ltd v Transnet Ltd* 2005 2 SA 202 (SCA) para 17.

[91] See "Contractual Obligations to Negotiate in Good Faith: Faithfulness to the Agreed Purpose" (2014) *LQR* 131 154-156.

[92] 2005 2 SA 202 (SCA) Para 17.

[93] McKerrow 2017 *Stell LR* 332-333.

If there is a guiding standard from which to construct the principal contract, courts can apply the objective doctrine of good faith to inform, direct and qualify the application of such guiding standard to determine the content of the envisaged contract.[94] In this thesis, it is proposed that a further requirement should be added - the court must conclusively determine that had the parties negotiated in good faith, they would have reached consensus on the outstanding term(s).[95] Nevertheless it is conceded here that this type of remedy can still be problematic because establishing whether consensus would have been reached (and on what terms) entails a speculative enquiry.

McKerrow also raises the concern that specific performance by judicial determination of outstanding term(s) disregards the subjective intention of the parties and treats pre-contractual agreements as enforceable agreements to agree rather than agreements to negotiate.[96] He proceeds to argue however that this type of specific performance is "fair, balanced and in line with our constitutional values" and is more practical than compelling parties to negotiate.[97] The aggrieved party would not object to such a remedy and in McKerrow's opinion the other party, by failing to negotiate in good faith, relinquishes his or her role in the determination of outstanding terms.[98]

In contrast to McKerrow, Lewis argues that although notions of reasonableness and fairness and the value of good faith are important, their application should not entirely displace other fundamental values such as legal certainty, party autonomy and freedom of contract, which includes freedom not to contract.[99] Parties should know what the content and legal consequences of their agreement are.[100] Parties could not possibly intend, in the absence of an express indication in their agreement to the contrary, that a failure to negotiate in good faith would result in the court filling in the outstanding terms of their agreement. It is unlikely that fairness, reasonableness and

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[94] McKerrow 2017 *Stell LR* 332.

[95] See ch 4 (4 2 2 1): this is a requirement in American law for an award of expectation damages.

[96] 2017 *Stell LR* 332.

[97] 331-332.

[98] 332.

[99] Lewis 2013 *THRHR* 81-82; D Hutchison "Non-variation Clauses in Contract: Any Escape from the Shifren Straitjacket?" (2001) 118 SALJ 720 744.

[100] Lewis 2013 *THRHR* 94.

the value of good faith can justify ignoring the original subjective intention of the parties and deprive them of their contractual autonomy for the failure to negotiate in good faith.

There is nevertheless some merit to Hutchison's and McKerrow's arguments for specific performance, particularly in circumstances where the contract to negotiate is intended to be binding and is the product of advanced negotiations. The suitability of this remedy will ultimately depend upon whether such a remedy was an intended consequence of the contract to negotiate and the court is of the view that the parties intended to be bound by the agreement notwithstanding outstanding terms. The possibility of granting this type of specific performance will depend on the willingness of the court to perform a so-called "gap filling" or deadlock-breaking function. Courts have emphatically held that they will not create a contract for the parties,[101] or subject them to an arrangement that is vastly "different in its essential character from what they had in mind"[102] when entering into the agreement.

Courts need to be extremely cautious of granting specific performance for breach of an agreement to negotiate. Parties often do not intend to be bound to the ultimate contract[103] and commonly include language negating liability in respect of the terms of the principal contract.[104] There are American academics that have pointed out that even if an agreement is comprehensive and only has a few open terms, specific performance may be inappropriate if the parties have not included a deadlock-breaking mechanism, and do not expressly or tacitly agree to a third party, in this case the court, determining the outstanding terms.[105] Outstanding terms are unknown to the parties themselves, much less capable of ascertainment by the court.

Although the above observations caution us against granting specific performance by judicial determination of outstanding terms, it is not necessary to dismiss the

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[101] Van Huyssteen et al *Contract* 218; *Namibian Minerals Corporation Ltd v Benguela Concessions Ltd* 1997 2 SA 548 (A) 561G–I; *Hurwitz v Table Bay Engineering (Pty) Ltd* 1994 3 SA 449 (C) 453 454-455; *H Merks & Co (Pty) Ltd v the B-M Group (Pty) Ltd* 1996 2 SA 225 (A) 235B-E.

[102] In *Hurwitz v Table Bay Engineering (Pty) Ltd* 1994 3 SA 449 (C) 453 454-455 Marais J expresses this opinion in relation to the ability of the court to intervene to make a binding determination of a price where a third party's determination is manifestly unjust.

[103] Knapp 1969 *NYU L Rev* 726; Sanders 2006 *UC Davis Bus LJ* 229.

[104] Foreman 2014 *U Toronto Fac L Rev* 30.

[105] Knapp 1969 *NYU L Rev* 725-726.

possibility of granting specific performance entirely, nor is it necessary to limit specific performance to cases where parties have expressly or tacitly agreed to the court determining the outstanding terms. In this thesis it is proposed that specific performance may be available even in circumstances where parties have not expressly or tacitly agreed to the court determining the outstanding terms in their contract.

In evaluating the possibility of awarding specific performance for breach of an agreement to negotiate, we will once again draw on the comparison between agreements to negotiate and pre-emption contracts. Bhana explains that where one is dealing with agreements such as pre-emption contracts, which require co-operation between the parties, an adjustment of mindset is necessary - courts will need to acknowledge that an equitable discretion to award specific performance now plays a more prominent role in judicial determinations.[106] It is essential for courts to invoke this judicial discretion when dealing with these types of agreements which require parties to co-operate and act in good faith. Pre-emption contracts also give rise to difficulties regarding specific performance of the positive obligation to cooperate in concluding the substantive contract by forcing the grantor to grant the preference, by making an offer to the grantee once the preference is triggered. Where parties conclude a pre-emption contract, they clearly intend to be bound by the obligation to cooperate in concluding the principal contract, and the commercial utility of these types of agreements will be lost entirely if a party cannot be compelled to enter into the contract to which the pre-emption right relates.[107]

It is however recognised that these proposals have been subject to academic criticism[108] and do not align with the *Associated South African Bakeries (Pty) Ltd v Oryx & Vereinigte Backereien (Pty) Ltd*[109] case which introduced the so-called "*Oryx* mechanism" for breach of a pre-emption contract. This remedy does not involve judicial discretion and entails that the holder of a pre-emption right unilaterally creates

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[106] 2010 *THRHR* 296. For criticism of Bhana's approach see Naudé T "Pre-Emption Agreements and the Myth of the 'Trigger Event' as Any Manifestation of a Decision to Sell: A Response to Deeksha Bhana" (2010) 74 THRHR 87-107, 103.

[107] 297.

[108] See Naudé T "Pre-Emption Agreements and the Myth of the 'Trigger Event' as Any Manifestation of a Decision to Sell: A Response to Deeksha Bhana" (2010) 74 THRHR 87-107, 103.

[109] 1982 3 SA 893 (A) 907E-G.

a contract on similar terms to that which the grantor concluded with the third party. The holder of the pre-emption right therefore steps into the shoes of the third party. The intricacies and complexities around remedies for breach of a pre-emption contract fall beyond the scope of this thesis. Suffice it to say, that notwithstanding the challenges regarding specific performance in the context of pre-emption agreements, courts have nevertheless recognised the validity of such agreements and have been willing to award specific performance. As such, it is proposed that courts could in a similar vein recognise the validity of agreements to negotiate and construct an appropriate form of specific performance. It is however emphasised that specific performance for breach of an agreement to negotiate will not take on the form of the *Oryx* mechanism.

It is proposed that agreements to negotiate that are expressly or by implication intended to be legally binding and are a product of advanced negotiations where most of the terms have been agreed upon, the principle of *pacta sunt servanda* demands that courts exercise an equitable discretion to enforce the substantive agreement by either obliging the parties to reach consensus on the outstanding term(s) according to the *arbitrium boni viri* or determining the outstanding term for the parties with reference to what is objectively reasonable. In this manner, a party is obliged to comply with his or her co-operation obligation in good faith. Bhana provides useful insight into how an award of this type of specific performance can be practically executed. She explains that the court would be guided by the context and the *arbitrium boni viri* standard which it should apply; this will ultimately align with the reasonable expectations of the parties.[110] It is acknowledged that the application of this reasoning in the context of agreements to negotiate is distinct because breach of a pre-emption right is generally triggered by an offer or conclusion of the contract with a third party, which gives some indication of the terms on which the grantor was willing to conclude the contract. Nevertheless the Bhana's suggestions for the practical execution of specific performance has merit in the context of agreements to negotiate.

From the explanation above, it is possible to formulate the following legal position. Breach of independent agreements to negotiate, entered into prior to the main contract, will generally in most jurisdictions (enforcing these types of agreements) not

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[110] 299.

give rise to the remedy of specific performance of the final contract, with the court determining outstanding terms. Nevertheless, breach of other types of agreements to negotiate may justify the court fulfilling a deadlock-breaking function. In the light of the preceding comparative observations and exposition of local academic opinion, the following requirements for such a remedy to be available is proposed.

Firstly, parties must have expressly agreed to be immediately bound by the contract notwithstanding outstanding terms, or it must be possible for the court to reasonably infer from the surrounding circumstances and the stage of negotiations reached that parties intended to be bound by the substantive agreement despite outstanding terms. Secondly, the agreement should be a product of advanced negotiations where parties have reached consensus on most of the terms of the principal contract. Thirdly, it must be clear with reasonable certainty that had parties negotiated in good faith, consensus would have been reached on outstanding term(s). Lastly it must be possible to identify or infer some form of machinery to determine outstanding terms, so that courts are neither making a contract for the parties nor substituting the parties' machinery with their own. This machinery could be derived from evidence adduced by the parties regarding the negotiations on outstanding terms (and any terms that may have been proposed), the use of standard commercial terms, and from the content of the agreement itself (for example reference to some standard that could be applied to determine outstanding terms). In practice it will probably be difficult for all these conditions to be satisfied, and it is therefore argued that this type of specific performance will seldom be an appropriate remedy for breach of an obligation to negotiate.

(ii) Directing parties to appoint an arbitrator to determine outstanding terms

Thus far, we have considered the possibility of completing outstanding terms by judicial determination. It is now necessary to consider the possibility of other potential deadlock-breakers that may exercise a discretion to determine outstanding terms. Hutchison, in constructing a remedy for breach of negotiation clauses forming part of binding preliminary agreements, looks to the "simplicity" of the remedy constructed by the court in *Southernport*.[111] In this case, there was an arbitration clause and the court

[111] 2011 *SALJ* 294.

ordered that the arbitrator should determine the outstanding terms.[112] He proceeds to suggest that the most appropriate remedy for breach of a binding preliminary agreement that does not contain a deadlock-breaking mechanism is an order compelling parties to appoint an independent arbitrator to determine the outstanding term(s) of the contract.[113]

Once again, this remedy is limited to a specific type of agreement.[114] Hutchison explains that outstanding term(s) would need to be readily ascertainable with reference to an external standard.[115] While conceding that this remedy is drastic, he argues that the proposed remedy gives effect to the right of an aggrieved party to claim specific performance for breach of a contractual obligation.[116]

This remedy addresses the failure of the parties to include a deadlock-breaking mechanism and the court does not make a contract for the parties.[117] Hutchison concludes that this remedy would constitute a "tangible and credible sanction to what is otherwise a toothless duty to negotiate".[118] There are advantages and disadvantages to the possibility of arbitrators performing this function. Advantages to arbitral determination of outstanding terms are that arbitration is a faster and cheaper means of resolving deadlock, and that arbitrators dealing with commercial disputes on a regular basis may have more experience or knowledge than courts regarding the content of commercial agreements. Conversely it can be argued that only courts are in a position to make a binding determination regarding the validity of an agreement (unless the parties have agreed to refer disputes to an arbitrator) and in any event courts are better placed to exercise the power *arbitrium boni viri*. It is therefore argued that determination of outstanding terms by an arbitrator will not be appropriate unless agreed upon by the parties or specifically so determined by the court.

Fontaine and De Ly in their analysis of pre-contractual agreements in various European legal systems conclude that the type of cases that would be suitable to entrust the completion of negotiations (determination of outstanding terms) to a judge

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[112] 294.
[113] 294.
[114] 294.
[115] 294.
[116] 294.
[117] 294.
[118] 294.

or an arbitrator will be extremely rare in practice.[119] The analysis above appears to support this contention. If specific performance is not available as a remedy, the aggrieved party is left with a claim for damages. This remedy shall now be considered.

4 2 2 Damages

The analysis above reveals that specific performance may not always be an appropriate remedy for breach of an obligation to negotiate. This suggests that the remedy of damages must be considered as an appropriate alternative. Again a comparative perspective may be instructive.

One of the justifications cited for the unenforceability of agreements to negotiate is the difficulty in assessing damages.[120] Beatson, Burrows and Cartwright question this rationale, arguing that it has been possible for courts to assess damages in other contexts, where "the transaction contains a large amount of chance."[121] Nedzel also objects to this rationale, describing it as "specious".[122] She argues that difficulties assessing damages should not exclude the possibility of enforcement; it should merely confine the type of damages awarded.[123] In this regard American and English law, which tend to grant damages as the primary remedy for breach of contract,[124] sometimes draw a somewhat challenging distinction between types of damages. These are damages measured by the reliance interest and the expectation interest.[125] Reliance damages is a monetary award placing the injured party in the position he would have been in had no contract been concluded.[126] Expectation damages is a

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[119] *Drafting International Contracts* 50.

[120] Pannebakker *Letter of Intent* 194; Farnsworth 1987 *Colum LR* 267; *Courtney & Fairbairn v Tolaini Bros (Hotels) Ltd* [1975] 1 WLR 297 301.

[121] *Anson's Law of Contract* 30 ed (2016) 69-70 referring to the case of *Allied Maples Group v Simmons & Simmons* [1995] 1 WLR 1602, 1620; see also *Petromec Inc v Petroleo Brasileiro SA Petrobras* [2005] EWCA Civ 891 para 117 where Longmore LJ argues that assessment of damages for breach of an obligation to negotiate in good faith can be easy.

[122] Nedzel 1997 *Tul Eur & Civ LF* 121-122.

[123] 121-122.

[124] Pannebakker *Letter of Intent* 194; EA Farnsworth *Contracts* 4 ed *(*2004) 735; E Peel *Treitel on the Law of Contract* 14 ed (2015) 1106; Nedzel 1997 *Tul Eur & Civ LF* 147.

[125] Pannebakker *Letter of Intent* 194; Farnsworth *Contracts* 729-732; *Restatement (Second) of Contracts* 344; Peel *Law of Contract* 1121-1126; HG Beale "Damages" in HG Beale (gen ed) *Chitty on Contracts I: General Principles* 32 ed (2015) 1809; Van Huyssteen et al *Contract* 403.

[126] Farnsworth *Contracts* 730; *Restatement (Second) of Contracts* 344 (b); Peel *Law of Contract* 1125;

monetary award placing the injured party in the position he would have been in had the contract been successfully performed.[127] The extent to which different type of damages should be awarded for breach will now be considered.

4 2 2 1 Reliance damages

Both civil-law systems, such as German law, and common-law systems, such as American law, appear to accept that breach of an obligation to negotiate in good faith may give rise to a claim for reliance damages.[128] Although South Africa has yet to enforce an agreement to negotiate in the absence of a deadlock-breaking mechanism, academics seem to agree that an aggrieved party should be entitled to claim their reliance losses for breach of such an obligation (if it were to be enforced).[129]

Some foreign academics are firmly of the opinion that in most cases an award of reliance damages is the only appropriate remedy for breach of a contractual duty to negotiate.[130] In order to understand the rationale behind this view, it is necessary to briefly refer to the proposed purpose of obligations to negotiate. In American law, the majority of cases have dealt with negotiation obligations arising from type II preliminary agreements.[131] The purpose of concluding such agreements is clearly not to guarantee conclusion of the envisaged contract, and therefore must lie in compelling parties to comply with a certain standard of conduct in the course of negotiations. If this is the case, what interests are the parties seeking to protect by agreeing to such

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Beale "Damages" in *Chitty on Contracts* 1809; Van Huyssteen et al *Contract* 403-404.

[127] Farnsworth *Contracts* 732; *Restatement (Second) of Contracts* 344(a); Peel *Law of Contract* 1121; Beale "Damages" in *Chitty on Contracts* 1809-1810; Van Huyssteen et al *Contract* 404.

[128] Temkin 1986 *Fordham L Rev* 723; Nedzel 1997 *Tul Eur & Civ LF* 121-122; Fontaine & De Ly *Drafting International Contracts* 51; JM Creed "Integrating Preliminary Agreements into the Interference Torts" (2010) 110 *Colum LR* 1253 1254 1272-1273; Sanders 2006 *UC Davis Bus LJ* 230; BS Markesinis, H Unberath & AC Johnston *The German Law of Contract: A Comparative Treatise* 2 ed (2006) 99-100.

[129] Van Huyssteen et al *Contract* 222; Hutchison 2011 *SALJ* 293-294; McKerrow 2017 *Stell LR* 333; see also ch 5 (5 2 3).

[130] Farnsworth 1987 *Colum LR* 264; A Schwartz & RE Scott "Pre-Contractual Liability and Preliminary Agreements" (2007) 120 *Harv L Rev* 661 703-704; Sanders 2006 *UC Davis Bus LJ* 230; N Cohen "Pre-Contractual Duties: Two Freedoms and the Contract to Negotiate" in J Beatson & D Friedman (eds) *Good Faith and Fault in Contract Law* (1995) 25 36, 49; Moss *International Commercial Contracts* 98; Fontaine & De Ly *Drafting International Contracts* 51-52; Nedzel 1997 *Tul Eur & Civ LF* 147.

[131] See *Teachers Insurance and Annuity Association of America v Tribune Co* (1987) 670 F Supp 491 (S D N Y) 499; see 3 2 2 1 (ii).

an obligation?

Various academics suggest that parties conclude these agreements because they wish to protect themselves against wasted reliance expenditure if negotiations are terminated in bad faith.[132] According to this theory, a contractual obligation to negotiate manages the allocation of risk between parties particularly where one party has made substantial relationship-specific investments and is at risk of sustaining financial loss if the other party suddenly discontinues negotiations.[133] On this understanding reliance damages is the intended remedy for breach of an obligation to negotiate.

There is also another compelling reason why reliance damages constitute the preferred remedy in American law. In the American case of *Copeland v Baskin Robbins USA*[134] the court confirmed that proof of expectation damages is impossible because terms of the envisaged transaction are unknown, and it is uncertain whether the principal contract will materialise; therefore, a party's claim for breach of an agreement to negotiate is limited to reliance damages and not the "party's lost expectations under the prospective contract". Americans courts are more inclined to award reliance damages for breach of an obligation to negotiate in good faith,[135] as it is a robust means for assessing loss because it is often readily ascertainable.[136]

Some scholarly discussions regarding development of the English law on agreements to negotiate address the controversial issue of appropriate remedies for breach if these agreements were to be enforced.[137] Peel explains that difficulties in assessing damages for breach of agreements to negotiate is limited to the award of expectation damages.[138] The same problems are not encountered with reliance damages, which reimburse parties for wasted costs incurred in the course of

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[132] Farnsworth 1987 *Colum LR* 264; Schwartz & Scott 2007 *Harv L Rev* 667, 703-704; Creed 2010 *Colum LR* 1253, 1254, 1272-1273; Sanders 2006 *UC Davis Bus LJ* 227-228.

[133] Creed 2010 *Colum LR* 1254, 1272-1273; Schwartz & Scott 2007 *Harv L Rev* 667, 703-704; Creed 2010 *Colum LR* 1254,1273-1274; See also ch 2 (2 3 5) and *Feldman v Allegheny International Inc* (1988) 850 F 2d 1217 (7th Cir) 1221.

[134] 117 Cal Rptr 2d 875 (Cal.ct App 2002) 884, 886; see also *Goodstein Const Corp v City of New York* (1992) 604 NE 2d 1356 (NY) 373-374; *Evans Inc v Tiffany & Co* (1976) 416 f Supp 224 (N.D III) 263-269.

[135] Nedzel 1997 *Tul Eur & Civ LF* 147.

[136] Sanders 2006 *UC Davis Bus LJ* 230.

[137] Pannebakker *Letter of Intent* 144.

[138] "Agreements to Negotiate" in *Contract Formation* 58.

unsuccessful negotiations.[139] He concludes that reliance damages would be the most readily available remedy for breach.[140] Loveridge and Mills also seem to support this conclusion. In this regard they draw a comparison with mediation cases, where English courts award damages measured by the wasted cost incurred due to an "unreasonable failure to negotiate".[141] Nominal damages may also be awarded for breach.[142]

In German law the remedy for breach of a legal duty to negotiate in good faith is also limited to reliance damages.[143] Nedzel explains that reliance damages are preferable because "it was the fault of the promisor that gives rise to liability and not the unmet expectations of the promisee".[144] If like a legal duty to negotiate, a contractual duty to negotiate regulates the process rather than the outcome of negotiations then reliance damages is the most suitable remedy. The more difficult question is whether an injured party's claim for breach of a contract to negotiate should always be limited to reliance damages or whether there are cases that justify an award of expectation damages.[145] It is to this question that the discussion now turns.

4 2 2 2 Expectation damages

Expectation damages are often regarded as an inappropriate remedy for breach of an agreement to negotiate because of uncertainty regarding the outcome of negotiations and the terms of principal contract.[146] However, Knapp,[147] as well as Burton and Anderson,[148] argue that while agreements to negotiate may indeed give rise to greater

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[139] 58.

[140] 59.

[141] "The Uncertain Future of *Walford v Miles*" (2011) 4 *LMCLQ* 529; see also Pannebakker *Letter of Intent* 145.

[142] *Hillas and Co v Arcos Ltd* 1932 147 LT 503 (HL) 515.

[143] Nedzel 1997 *Tul Eur & Civ L* 147; C Kunze *The Letter of Intent, with Special Emphasis on its Relevance in International Trade Law* unpublished LLM Mini thesis Stellenbosch University (2014) 33-34; Fontaine & De Ly *Drafting International Contracts* 51; Kottenhagen 2006 *Ius Gentium* 77; J Dietrich "Classifying Precontractual Liability: A Comparative Analysis" (2001) 21 *Legal Stud* 153, 179.

[144] 1997 *Tul Eur & Civ L* 147; Fontaine & De Ly *Drafting International Contracts* 51.

[145] Knapp 1969 *NYU L Rev* 723; Hutchison 2011 *SALJ* 293.

[146] Farnsworth 1987 *Colum LR* 263-264, 267; Schwartz & Scott 2007 *Harv L Rev* 703-704; Temkin 1986 *Fordham L Rev* 162,163,169; Nedzel 1997 *Tul Eur & Civ L* 121-122; Foreman 2014 *U Toronto Fac L Rev* 16-17; Hutchison 2011 *SALJ* 293-294; McKerrow 2017 *Stell LR* 333.

[147] 1969 *NYU L Rev* 723-724.

[148] *Contractual Good Faith: Formation, Performance, Breach, Enforcement* (1995) 365.

uncertainty, it does not follow that the remedy should always be confined to reliance damages.[149] For example if the parties have agreed to all essential terms of the principal contract, then there will be sufficient certainty for courts to assess the expectation damages based on the tentative agreement.[150] The fundamental question is whether the court can determine the economic gains that the aggrieved party would have obtained in respect of the final contract.[151] Expectation damages may be awarded, in terms of American law, if the instrument in question constitutes an enforceable "agreement with open terms."[152] Lake and Draetta argue that expectation damages should only be awarded if the agreement is complete regarding the envisaged transaction, and not just complete as an agreement to negotiate.[153]

In South African law, an award of expectation damages for breach of an obligation to negotiate gives rise to difficulties even when one is dealing with an agreement to negotiate that is intended to be immediately binding and only has one or two outstanding terms.[154] As in other legal systems, the existence of outstanding term(s) makes it difficult for courts to assess the aggrieved party's position, had contractual obligations been discharged.[155] Hutchison argues that if courts exercise their discretion not to award specific performance by filling in outstanding terms and enforcing the substantive contract, they may nonetheless award expectation damages if the outstanding terms are capable of "objectively reasonable determination".[156] This type of agreement that Hutchison describes appears to be similar to the American concept of an agreement with open terms and it is clearly distinguishable from an independent agreement to negotiate that is entered into prior to the main contract.

Independent agreements to negotiate, whether they outline some of the terms or merely record an arrangement to negotiate could not possibly have been intended to

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[149] See also the discussion of Eisenberg *Foundational Principles of Contract Law* (2018) 514-515.

[150] Knapp 1969 *NYU L Rev* 723-724,725; Burton & Anderson *Contractual Good Faith* 365.

[151] Burton & Anderson *Contractual Good Faith* 365-366.

[152] Farnsworth 1987 *Colum LR* 255; Nedzel 1997 Tul *Eur & Civ L* 147.

[153] *Letters of Intent and Other Pre-Contractual Documents: Comparative Analysis and Forms* (1989) 164.

[154] Hutchison 2011 *SALJ* 294.

[155] 294.

[156] 295.

give rise to a claim for expectation damages in the event of breach.[157] Expectation damages are aimed at placing a party in the position he would have been in had the other party discharged their contractual obligations, whereas most agreements to negotiate do not guarantee the materialisation of the principal contract.[158] If courts were to grant expectation damages, in these circumstances, they would essentially have to speculate regarding whether the principal contract would have materialised, and if so, on what terms.[159]

Due to these reasons, American courts have traditionally refused to award expectation damages for breach of type II preliminary agreements.[160] There have, however, been recent developments in this regard. In *Venture Associates Corporation v Zenith Systems Corporation*[161] Posner CJ explained that if, even in the absence of bad faith, negotiations would have been unsuccessful, then the injured party's claim would be limited to reliance damages.[162] He then proceeded to recognise that expectation damages could be awarded if the injured party can prove that the final contract would have been concluded, but for the other party's bad faith.[163] Concerns regarding the award of expectation damages "goes to the practicality of the remedy, not the principle of it".[164]

In *Network Enterprises, Inc v APBA Offshore Productions, Inc*[165] Haight DJ recognised the difficulties regarding the award of expectation damages but found that such difficulties do not exist in every case.[166] This case dealt with a renewal option that required negotiations regarding times and dates of telecasts.[167] Haight DJ concluded that the "apparent ease with which the parties agreed to the dates and times" in the previous contract supported the conclusion that had parties negotiated in

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[157] Creed 2010 *Colum LR* 1273.

[158] Foreman 2014 *U Toronto Fac L Rev* 32; Creed 2010 *Colum LR* 1273.

[159] Foreman 2014 *U Toronto Fac L Rev* 32.

[160] 30-31.

[161] (1996) 96 F 3d 275 (7th Cir) 278-279.

[162] 278.

[163] 278.

[164] 279.

[165] (2006) 427 F Supp 2d 463 (S D N Y) 487.

[166] 487.

[167] 480.

good faith the outstanding terms would have been agreed upon.[168]

In the seminal case of *Siga Technologies Inc v PharmaAthene Inc*[169] ("*Siga*") Steele CJ expressed similar sentiments and confirmed that if a court finds "that the parties would have reached an agreement but for the defendant's bad faith negotiation" expectation damages will be available as a remedy for breach of a type II preliminary agreement.

It is significant that in all of these cases, the agreements outlined most of the terms of the principal contract and therefore required less speculation.

Foreman criticises the logic applied in these cases, arguing that it fails to account for the uncertainty of the obligation to negotiate in good faith.[170] It is difficult to see how courts can infer from a pre-contractual agreement containing outstanding terms that a contract would have been concluded "but for the defendant's bad faith".[171] Such a conclusion ignores issues that may be raised by due diligence and future impediments potentially preventing contract conclusion.[172] Expectation damages imply the existence of a principal contract where there is not in fact one.[173]

Rios in his commentary on article 2.1.15 of the PICC[174] argues that it is debatable whether a party should be entitled to expectation damages when parties have not reached agreement on the final terms of the contract.[175] However, he does concede that the award of expectation damages will ultimately depend on the type of agreement to negotiate and how far parties have advanced in negotiations.[176]

In conclusion the arguments made by Foreman against an award of expectation damages are compelling. Expectation damages are aimed at placing the party in the position he would have been in had the contract been concluded. For a court to award such damages, it would need to speculate about whether good faith negotiations would have resulted in parties reaching consensus on outstanding terms. Even if the

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[168] 487.

[169] (2013) 67 A 3d 330 (Del) 349-352.

[170] 2014 *U Toronto Fac L Rev* 34.

[171] 34.

[172] 34.

[173] 16-17,37.

[174] See ch 4 (4 2).

[175] "Art. 2.1.15 - 2.1.16 Negotiations" in S Vogenauer (ed) *Commentary on the PICC* 361-362.

[176] 362.

agreement to negotiate is comprehensive, the court would still be required to enter into the realm of speculation regarding the outstanding term(s). This creates the risk of essentially imposing, in the monetary sense, a contract on the parties with terms they may not have intended.

4 3 Remedies for breach of non-disclosure obligations

Confidentiality or non-disclosure clauses are commonly included in pre-contractual agreements because valuable confidential information is often disclosed in the course of commercial negotiations**.** Confidentiality obligations can arise from other sources of law,[177] but parties often conclude confidentiality agreements to ensure their confidential information is protected. These agreements will generally also list the penalties, damages or injunctive relief available for breach of confidentiality.[178]

Confidential information has an economic value that will be diluted or destroyed if information is disclosed in breach of a confidentiality agreement. There are two main remedies for breach of this obligation, namely an interdict preventing disclosure of confidential information and damages**.** It is important that an interdict is only useful where the harm is not "irremediable",[179] as it can only prevent the anticipated use or disclosure of confidential information. If an interdict is not available, the aggrieved party may claim damages.[180]

There appears to be limited local and foreign literature and case law on remedies for breach of confidentiality obligations in pre-contractual agreements. This may be explained by difficulties in establishing breach,[181] the inclusion of liquidated damages clauses and the existence of other sources of liability for breach of confidentiality.[182] Fontaine also points to the scepticism regarding "the possibility of enforcing compliance with a confidentiality undertaking".[183] This analysis will consider remedies for breach provided in foreign law and international instruments and compare it to

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[177] See ch 5.

[178] U Babusiaux "Art 2:302: Breach of Confidentiality" in N Jansen & R Zimmermann (eds) *Commentaries on European Contract Laws* (2018) 378.

[179] Fontaine & De Ly *Drafting International Contracts* 285.

[180] 296.

[181] M Fontaine "Confidentiality Agreements in International Contracts" 1991 *Int'l Bus LJ* 81-82.

[182] See ch 5.

[183] 1991 *Int'l Bus LJ* 5 8-10,81-82.

South African law.

4 3 1 English and American law

The common-law tradition distinguishes between contractual and equitable remedies for breach of confidentially.[184] An equitable obligation of confidentiality arises from a "general duty of trust and confidence"[185] derived from equity, and applies during the negotiation period even in the absence of a contractual obligation.[186] Breach of contractual confidentiality obligations gives rise to remedies such as an interdict, which is discretionary, and damages.[187]

In English law contractual damages are generally assessed according to the aggrieved party's loss as a result of the disclosure or use of information.[188] In *Attorney General v Blake*[189] however, the court found that some cases will justify the award of damages measured by the aggrieved party's loss of profits. This is the equitable remedy for breach of a duty of confidence and the court concluded that there is no reason for such damages to be available "in respect of an equitable wrong" but not for breach of a contractual confidentiality obligation.[190]

English courts typically measure damages by the "value of a notional reasonable agreement to buy release"[191] from the confidentiality agreement.[192] Whether a court will deviate to measure damages by the loss of profits will depend on the nature of the confidentiality obligation.[193] If the contractual obligation is similar to the "fiduciary obligation" developed from equity, it may be appropriate for the court to award the lost profits.[194]

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[184] LA Tompkins "Confidentiality Agreements in a Commercial Setting: Are They Necessary" (2008) 27 *ARELJ* 198 205.

[185] 199.

[186] Tompkins 2008 *ARELJ* 199; Pannebakker *Letter of Intent* 127,147,159; *Seager v Copydex Ltd* [1967] 1 WLR 923 (EWCA).

[187] CS Harrison *Make the Deal: Negotiating Mergers and Acquisitions* (2016) 23; Tompkins 2008 *ARELJ* 205.

[188] Tompkins 2008 *ARELJ* 205.

[189] [2000] 4 All ER 385.

[190] 385.

[191] *Vercoe v Rutland Fund Management Ltd* [2010] EWHC 424 (Ch) 334.

[192] 334, 339.

[193] 339, 344, 345

[194] 339, 344, 345.

American law recognises that breach of a confidentiality obligation can have significant detrimental effects on an aggrieved party's business and in these circumstances it will be appropriate for a court to grant an interdict compelling parties to comply with their obligation.[195] If the requirements for an interdict cannot be met, the party may claim damages.

There are often difficulties in providing evidence to prove the damage suffered as a result of a breach of confidentiality,[196] and the damages that can be proven may be far less than the damage actually suffered.[197] For this reason parties may include a liquidated damages clause.[198] In certain foreign legal systems it is also standard practice to include a provision to the effect that remedies provided by law may be inadequate, and that the parties agree that equitable remedies such as an injunction will be available in the event of breach.[199] Such a provision can also provide that breach of confidentiality will constitute irreparable harm and the party consents to the aggrieved party applying for injunctive relief.[200] In American law, some courts have been willing to conclude that an aggrieved party has demonstrated irreparable harm, due to the mere existence of such a clause while other courts have not done so.[201]

4 3 2 International instruments

The PICC,[202] the Principles of European Contract law (PECL)[203] and the Draft Common Frame of Reference (DCFR)[204] all recognise an automatic obligation of confidentiality during negotiations and deal with remedies available for breach. These instruments recognise that an aggrieved party will be entitled to damages that

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[195] TL Stark *Negotiating and Drafting Contract Boilerplate* (2003) 209.

[196] See ch 2 (2 2 5).

[197] RB Lake & U Draetta "Pre-contractual Documents in Merger and Acquisition Negotiations- An Overview of the International Practice" 1991 *Int'l Bus LJ* 229 230.

[198] See ch 2 (2 2 5); MA Denicolo *Acquisitions 2017* (2017) para 2 5 1; P Mäntysaari *The Law of Corporate Finance: General Principles and EU Law III* (2010) 407.

[199] Lake & Draetta 1991 *Int'l Bus LJ* 229-230.

[200] F Adoranti *The Managers Guide to Understanding Confidentiality Agreements* (2006) 59; NS Kim *The Fundamentals of Contract Law and Clauses: A Practical Approach* (2016) 190-191.

[201] Cf *Martin Marietta Materials Inc v Vulcan Materials Company No 254* (Del July 10, 2012); *Riverside Publishing Co v Mercer Publishing LLC* No 11-1249 (W.D 2011).

[202] See art 2.1.16.

[203] See art 2:302.

[204] See art 3:302 (1).

compensate any losses suffered and any benefit received by the party as a result of the use or disclosure of confidential information.[205] The PICC provides that the quantum of damages will vary depending on whether a confidentiality agreement has been concluded and the content thereof.[206] An injunction is also available in terms of the applicable law to prevent anticipated disclosure or use of confidential information.[207]

4 3 3 South African law

South Africa, unlike common-law systems such as England, has no law of equity that gives rise to an equitable duty of confidentiality. The circumstances in which a duty of confidentiality will arise in terms of South African law can be considered with reference to *Meter Systems Holdings Ltd v Venter*[208] *("Meter Systems Holdings")* In this case the court explained that an obligation of confidentiality can arise in the law of delict (on the basis of the application of the principles of Aquilian liability) or in the law of contract. We shall focus on the latter source of an obligation of confidentiality.[209] Parties may choose to enter into a contract that contains a confidentiality obligation and the parties are free to define the exact scope or purpose of such an obligation. On the other hand, certain contracts that create a fiduciary relationship will give rise to an ex lege obligation of confidentiality (i.e a contractual duty of confidentiality is implied by law into the contract).[210] The court in the *Meter Systems Holdings*[211] case gives examples of the types of contracts which will give rise to an ex lege confidentiality obligation; these include employment contracts, contracts between a banker and a customer, and contracts between a doctor and a patient. In *Alum-phos (Pty) Ltd v Spatz*[212] ("*Spatz*") the court explained that it is an implied term in every contract of service that an employee will not disclose or utilise confidential information acquired during his course of employment and this obligation often survives after termination of employment.

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[205] See PICC art 2.1.16 read with comment 3; PECL art 2:302; DCFR art 3:302(4).

[206] Art 2.1.16 read with comment 3.

[207] Art 2.1.16 read with comment 3.

[208] 1993 (1) SA 409 (W).

[209] 428 A.

[210] 426A-C.

[211] 426F-G.

[212] [1997] 1 All SA 616 (W) 623.

Confidentiality provisions are also commonly included or inferred into restraint of trade agreements. The types of remedies available for breach of an express or implied obligation of confidentiality, namely an interdict and damages, will now be considered with reference to case law.

In the *Spatz*[213] case, the court awarded an interdict preventing and restraining the employee from divulging or utilising the confidential information acquired during the course of employment. In *Traka Africa (Pty) Ltd v Amaya Industries*[214] the parties concluded a confidentiality agreement that prohibited the second respondent, an ex-employee of the company, from disclosing or using confidential information.[215] The second respondent breached the confidentiality obligation by utilising such information under the employment of the first respondent for purposes of competing with the applicant.[216] The court granted an interdict preventing the other party from using or disclosing confidential information and directed them to return all confidential documents.[217] The court concluded that damages would not be a suitable remedy because it was impossible to quantify the damages and by the time an action for damages was heard, the aggrieved party's business would potentially be destroyed.[218]

In *Valunet Solutions Inc t/a Dinkum USA v eTel Communication Solutions (Pty) Ltd*[219] the parties concluded a confidentiality agreement to protect the confidential information and trade secrets disclosed during contractual negotiations. This confidential information was protected by way of a restraint of trade clause enduring ten years.[220] Van Oosten J refused to enforce such clause because it unreasonably fettered the respondent's freedom of trade.[221] He also refused to grant an interdict because by the time the application was brought, the information had become general knowledge, and the applicant in any event had the alternative remedy of damages at

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[213] 634.

[214] [2016] ZAGPJHC 24 para 87.

[215] Paras 11-12.

[216] Paras 12-26.

[217] Para 87.

[218] Paras 67-69.

[219] 2005 3 SA 494 (W) para 3.

[220] Para 19.

[221] Para 20.

its disposal.[222] It is thus clear that an interdict will only be granted where further harm can and should be prevented, otherwise the claim will be limited to damages.

Although South African case law dealing with breach of a confidentiality obligation primarily focuses on an award of an interdict, it is clear that a claim for damages can also lie as outlined in the aforementioned case. It is proposed that a claim for damages should place the aggrieved party in the position he or should would have been in had the other party complied with their confidentiality obligation.

4 4 Remedies for breach of exclusivity obligations

Exclusivity provisions are also commonly included in pre-contractual agreements and require parties to refrain from negotiating with third parties for a specific length of time.[223] American and English law have recognised the enforceability of exclusivity clauses in the pre-contractual context, but there is little case law dealing with remedies for breach of this obligation. This may be explained by the inclusion of liquidated damages or break-up fee clauses that commonly accompany exclusivity provisions.[224] There are two main remedies for breach of an obligation to negotiate exclusively, namely an interdict and damages.

4 4 1 English and American law

In terms of English law an interdict may be granted to prevent breach of an exclusivity obligation, but this will only restrain a party from negotiating with third parties; it will not impose a positive obligation to negotiate or conclude the final contract.[225] In *Tye v House,*[226] an English court refused to grant an injunction because reliance damages could adequately meet the purpose of the exclusivity agreement.[227] In *Pitt v PHH Asset Management,*[228] the court also awarded damages. Damages are usually limited to

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[222] Paras 17-18.

[223] Farnsworth 1987 *Colum LR* 279.

[224] See ch 2 (2 2 5).

[225] R Bradgate "Formation of Contracts" in M Furmston (gen ed) *The Law of Contract* (2010) 255 454; J Cartwright *Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer* (2016) 88-89; A Kouloridas *The Law and Economics of Takeovers: An Acquirers Perspective* (2008)168.

[226] [1997] 41 EG 160 171.

[227] Bradgate "Formation of Contracts" in *Law of Contract* 454-455.

[228] [1994] 1 WLR 327 CA para 31.

compensation for losses suffered by the aggrieved party in reliance on negotiations as the purpose of an exclusivity agreement is to protect the party against wasted expenditure if the other party negotiates or concludes the contract with a third party during the exclusivity period.[229]

In American law, remedies for breach of an obligation to negotiate exclusively include interdicts and reliance damages[230], the latter being the primary remedy for breach.[231] In *Logan v DW Sivers*[232] the court explained that an exclusivity clause in a pre-contractual agreement is "directed to the manner of the negotiations and not to their outcome and the damages that may be deemed to have arisen from the defendant's breach of that promise are similarly limited".

Remedies for breach of this obligation are limited in both English and American law, and therefore to ensure certainty with regards to compensation parties may include a liquidated damage or "break-up fee" clause.[233] These clauses allow the aggrieved party to set a specific sum payable for breach and avoid the evidentiary difficulties in proving damages.[234]

4 4 2 South African law

There does not appear to be any reported South African case law on remedies for breach of an obligation to negotiate exclusively. This may stem from the inclusion of break-up fee clauses and parties electing not to enforce these agreements or settling out of court.

An interdict restraining a party from negotiating with third parties should theoretically be a remedy for breach of an obligation to negotiate exclusively. However, in the absence of an order compelling parties to negotiate, the other party who has been ordered to comply with an exclusivity obligation can merely wait for the period of exclusivity to lapse without making any effort to negotiate. Reliance damages thus

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[229] Bradgate "Formation of Contracts" in *Law of Contract* 454; J Poole *Textbook on Contract Law* 13 ed (2016) 91.

[230] Farnsworth 1987 *Colum LR* 264.

[231] *Walgreen Company v Sara Creek Property Company* (1992) 966 F 2d 273 (7th Cir) 275.

[232] 169 P 3d 1255 (Or 2007) 1263.

[233] Mäntysaari *The Law of Corporate Finance* 411-412; Denicolo *Acquisitions* para 2 5 2 2.

[234] Harrison *Make the Deal* 47; Yamazaki 2012 *NYU JL & Bus* 414-415, 425; Lake & Draetta 1991 *Int'l Bus LJ* 245-246; see also 2 2 5.

appears to be the only useful remedy for breach, but some commercial utility may nevertheless lie in preventing a party from negotiating with a third party.

4 5 Extra-judicial consequences of pre-contractual agreements

Business professionals often conclude transactions involving significant economic risk by means of informal agreements rooted in "common honesty and decency".[235] They expect that pre-contractual agreements will be abided by, irrespective of their uncertain legal effect. Studies conducted by Macaulay reveal that business professionals commonly settle contractual disputes without relying on legal sanctions or the threat thereof.[236] Sanctions (remedies for breach) often have little influence on parties' compliance with their contractual obligations.[237] Hwang, after having interviewed various American lawyers, concludes that legal liability for breach of an agreement to negotiate in good faith is both weak and limited.[238] Lawyers explain that pre-contractual agreements are rarely enforced in practice despite sophisticated parties being aware of their enforceability.[239] Enforceability has little effect on the parties' behaviour because the risk of enforcement is not regarded as a "real possibility" and the remedy is generally very limited and far exceeded by the exorbitant costs of litigation.[240] Furthermore business professionals generally strive to avoid legal enforcement of agreements or the threat thereof, because it can negatively influence their reputation in an economic sector and discourage others from doing business with them. [241]

Extra-judicial consequences offer an alternative explanation for why pre-contractual agreements affect parties' behaviour and promote compliance, even in the absence of legal enforcement.[242] Parties may be compelled to comply to protect their reputations, to ensure business relationships are maintained for future dealings, to avoid economic sanctions that may flow from non-compliance or out of a sense of

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[235] S Macaulay "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *ASR* 55 58.
[236] 61.
[237] Farnsworth *Contracts* 729.
[238] "Deal Momentum" (2018) 65 *UCLA L Rev* 376 394.
[239] 395.
[240] 394, 395, 414-415.
[241] Macaulay 1963 *ASR* 61.
[242] 379, 384.

moral obligation.[243] Potential economic consequences include the termination of business relationships, and harm to commercial credit.[244] These consequences are often more serious than the legal consequences.[245]

The reputational consequences potentially flowing from non-compliance with a pre-contractual agreement to negotiate (binding or non-binding) or a preliminary principle contract can either compel business professionals to comply or constitute a "punishment for breach".[246] Both Holten[247] and Hwang[248] agree that "reputational consequences" as an informal mechanism of enforcement has a limited scope of application, and only works in small industries where the aggrieved party and other parties within the market refuse to do business with the non-complying party.[249] In larger sectors of the economy, there is often a diverse range of business professionals with whom to pursue transactions and the risk of reputational consequences is considerably lower.[250] Hwang also highlights that many business professionals are not "repeat players" and do not fear future economic sanctions.[251]

Moral or ethical obligations imposed by pre-contractual agreements may be the strongest force promoting compliance of such agreements.[252] Hwang explains that moral pressure does not pose a threat of economic sanction, but rather encourages parties to comply out of the desire to appear to be an "integrity player".[253] Many parties involved in transactions attach great value to qualities such as integrity and morality in business, even if they are not involved in repetitive transactions.[254]

Holten suggests that parties enter into pre-contractual agreements out of necessity

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[243] Farnsworth *Contracts* 729; Hwang 2018 *UCLA L Rev* 409.

[244] Fontaine & De Ly *Drafting International Contracts* 55- 56.

[245] Fontaine & De Ly *Drafting International Contracts* 56; Johnson 1993 *Chi-Kent L Rev* 940.

[246] JA Holten "Letters of Intent in Corporate Negotiations: Using Hostage Exchanges and Legal Uncertainty to Promote Compliance" (2014) 162 *U Pa L Rev* 1238 1249.

[247] 1249-1250.

[248] Hwang 2018 *UCLA L Rev* 399.

[249] Holten 2014 *U Pa L Rev* 1249; Hwang 2018 *UCLA L Rev* 399.

[250] Holten 2014 *U Pa L Rev* 1249.

[251] Hwang 2018 *UCLA L Rev* 399.

[252] Hwang 2018 *UCLA L Rev* 409-410; Knapp 1969 *NYU L Rev* 679-683; Johnson 1993 Chi-*Kent L Rev* 944.

[253] Hwang 2018 *UCLA L Rev* 409-410410.

[254] 409.

when there is no other appropriate "legal regime" that will achieve the parties' intended outcome and they rely on extra-judicial mechanisms for compliance.[255] As examples of such mechanisms Holten lists "reputational consequences, private arbitration, or economic retaliation and collateral, or hostage, exchanges."[256] This analysis reveals that even in the absence of legal sanctions, some extra-judicial factors could influence compliance with pre-contractual agreements.

The existence of extra-judicial consequences, while relevant and useful do not entirely negate the necessity of carefully formulated legal rules that maintain legal certainty and promote the underlying values of good faith and *ubuntu*. Contract law performs a fundamental role in facilitating commercial transactions, but it is proposed that the South African law of contract should go a step further to promote fairness in contract and curb bad faith, and opportunistic, behaviour. Ultimately, only legal sanction and not extra-judicial functions alone can create a commercial framework that promotes both fairness and efficient contracting.

4 6 Conclusion

The investigation into the legal consequences and remedies for breach of the various types of pre-contractual agreements involved the exploration of a new and relatively undeveloped territory. This is particularly true in the South African context, where these agreements are only enforced to a limited extent. Foreign jurisdictions such as American law, in contrast, have been more receptive to attaching legal consequences to these types of agreements, but offer different and potentially incompatible solutions to the question of remedies. American law, for example, grants reliance damages as the primary remedy for breach of an obligation to negotiate, whereas South African law in contrast regards specific performance as the primary remedy for breach of contract.

Remedies for breach of these agreements to negotiate (assuming that they are contractually enforceable) in South Africa raises difficult issues regarding the proper

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[255] Holten 2014 U *Pa L Rev* 1252.

[256] Holten 2014 U *Pa L Rev* 1252; see 2 5 for a further discussion on economic hostage exchange and how it can influence parties' behaviour and encourage compliance. Temkin 1986 *Fordham L Rev* 170 explains that *Texaco Inc v Pennzoil Co* (1987) 729 S W 2d (Tex App) illustrates the "gamble" parties take because of uncertainty regarding whether a pre-contractual agreement will be enforced.

role of the courts, the intended consequences of such agreements, and the most effective means of enforcing them. This chapter, while recognising these difficulties, sought to determine appropriate remedies, which vary according to the type of agreement at hand.

We note that in all the legal systems under consideration, agreements to negotiate with deadlock-breaking mechanisms generally result in the principal contract coming into existence. The legal consequence of a breakdown in negotiations is that parties are compelled to negotiate in good faith and the deadlock-breaking mechanism operates as a forceful sanction and incentive to comply. In the event of breach of the afore-mentioned type of contract, a court is able to order specific performance of the contract by invoking the deadlock-breaking mechanism.

In the absence of a deadlock-breaking mechanism, the legal consequences and remedies for breach of agreements to negotiate are more complex. It is firstly possible that one is dealing with an independent agreement to negotiate, entered into prior to any envisaged principal contract, and that this independent agreement outlines a few of the major terms, or solely records an arrangement to negotiate a second contract in the future. The materialisation of the final contract is not guaranteed. In terms of American law, contractual obligations to negotiate in good faith (distinct from any contractual obligations obliging conclusion of the principal contract itself) are enforced and appear to give rise to the remedies of specific performance in the form of an order compelling parties to negotiate in good faith, and reliance damages.[257] This conclusion is justified by the fact that this type of obligation regulates the process rather than the outcome of negotiations.

Remedies for breach of this type of agreement in America (the only jurisdiction under consideration where they are currently enforced) are therefore appropriately limited to specific performance in the form of an injunction compelling parties to negotiate, and reliance damages. The efficacy of the former remedy in the absence of a deadlock-breaking mechanism is questionable. Parties have little incentive to negotiate seriously towards consensus, and achieving the aggrieved party's desired outcome is unlikely. Reliance damages therefore appear to be the most promising remedy for breach of this type of agreement. While South African law may theoretically

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[257] Jeffries 2012 *Gonz L Rev* 17.

be developed to recognise independent agreements to negotiate and award reliance damages for breach, the utility of such a development must be assessed in light of the availability of similar protection and remedies from non-contractual sources. This will be considered in chapter 5.[258]

Secondly it is possible that the agreement to negotiate outlines most of the terms of the envisaged transaction, and is intended to be binding, but has some open terms that have been left to future negotiations. These agreements contain the "contractual bones" of the envisaged transaction. Academics such as Hutchison and McKerrow propose that specific performance by enforcement of the principal contract, with the court or an arbitrator determining outstanding terms, is a potential remedy for breach of this agreement. This is a drastic and arguably too invasive remedy.

For courts to grant this remedy there must be some mechanism or means by which they can determine the outstanding terms. The court cannot substitute the party's machinery or mechanisms for that of its own, even if the party's own machinery, namely their agreement to agree or negotiate fails. It is argued that this type of specific performance will be an inappropriate remedy for breach if such a mechanism is not expressly provided by the parties or is incapable of being implied into the agreement in lieu of a deadlock-breaking mechanism. Furthermore, the contention that a party loses his right to finalise the outstanding terms of a contract for breach of an obligation to negotiate in good faith cannot be accepted in light of the fundamental importance of legal certainty and freedom of contract.

Finally, it must be appreciated that in practice, duties to negotiate, retain confidentiality or exclusivity may in any event not depend on legal remedies for their effectiveness. Business professionals often accept that resorting to legal sanction or the threat thereof can have significant detrimental effect on their business and future commercial relationships. They may therefore be unconcerned with the enforceability or contractual consequences of pre-contractual agreements. It is expected that business persons will abide by their agreements irrespective of legal consequences. Failure to do so is punished by commercial sanction which is often more severe. Nevertheless, while it may commercially risky to pursue legal action, significant losses can often incentivise an aggrieved party to seek enforcement of a pre-contractual

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[258] See ch 5.

agreement. The legal sanctions for breach of these obligations as outlined above would then remain relevant.

Chapter 5: Pre-contractual liability arising from sources other than contract

5 1 Introduction

Common-law systems such as England and America, and South Africa's mixed legal system attach great importance to freedom of contract and draw a clear distinction between the contractual phase, which traditionally gives rise to liability, and the pre-contractual phase which does not.[1] In these systems, parties are generally free to break off negotiations at any time and for any reason without attracting liability.[2] It is accepted that prior to contract formation any expenses incurred constitute a business risk assumed by a party in the course of negotiations.[3] It will be observed in this chapter that this "risk-based reasoning"[4] largely influences the imposition of pre-contractual liability even from non-contractual sources of law.

This conservative approach has attracted criticism.[5] Negotiating parties often incur expenses that are necessary to ensure or increase the likelihood of contract conclusion or to place themselves in a position to perform the anticipated contract.[6] Potential injustices could arise when the expenditures end up being wasted, particularly where one party is encouraged to incur them by the other party who

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[1] P Giliker *Pre-Contractual Liability in English and French Law* (2002) 31; G Klass *Contract Law in the USA* (2010) 98; EA Farnsworth "Pre-Contractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations" (1987) 87 *Colum LR* 217 221; EA Farnsworth *Contracts* 4 ed (2004) 189-190; A Hutchison "Liability for Breaking off Contractual Negotiations" (2012) 129 *SALJ* 104 104-105.

[2] Klass *Contract Law* 98; Farnsworth *Contracts* 189; *Walford v Miles* [1992] 2 AC 128 138*; Murray v McLean NO* 1970 1 SA 133 (R) 138; L Hawthorne & D Hutchison "Offer and Acceptance" in D Hutchison & C Pretorius (eds) *Law of Contract in South Africa* 3 ed (2017) 47 63; LF Van Huyssteen & CJ Maxwell *Contract Law in South Africa* 6 ed (2019) 103.

[3] Giliker *Pre-Contractual Liability* 31; E McKendrick "Work Done in Anticipation of a Contract Which Does Not Materialise" in WR Cornish, R Nolan, J O'Sullivan & G Virgo (eds) *Restitution - Past, Present and Future* (1998) 163 167,183; J Cartwright *Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer* (2016) 92; B MacFarlane "The Protection of Pre-Contractual Reliance: A Way Forward" (2010) 10 *OUCLJ* 95 96; Klass *Contract Law* 98; Farnsworth 1987 *Colum LR* 221; Farnsworth *Contracts* 189-190.

[4] Giliker *Pre-Contractual Liability* 67.

[5] LF Van Huyssteen, GF Lubbe & MFB Reinecke *Contract: General Principles* 5 ed (2016) 85.

[6] 85.

misrepresents their intention to conclude the contract. The questions that arise, and are considered in this chapter, are whether liability should be imposed on a party breaking off negotiations, what types of pre-contractual expenditure can be recovered, and what the basis of such liability should be.

There are certain preliminary observations that are pertinent to contextualising and answering these questions. Firstly, developing the law on pre-contractual liability is an extremely difficult task, because it entails balancing freedom of negotiation, which is essential to a growing market economy, with indemnifying parties against pre-contractual losses, which encourages efficient investment in negotiations, potentially increasing the transaction's profitability.[7]

Secondly the nature and extent of pre-contractual liability is affected by whether the specific jurisdiction imposes an overarching obligation to negotiate in good faith. Unlike most common-law systems,[8] civil-law systems commonly recognise an independent pre-contractual obligation that requires parties to consider each other's interests during negotiations.[9] In the former systems liability generally arises from a number of different sources, as opposed to an overarching source.[10] English and American courts, for example, have become more willing to intervene in the pre-contractual phase to prevent injustice or unfairness and have done so on the basis of

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[7] HG Beale, B Fauvarque-Cosson, J Rutgers, D Tallon & S Vogenauer *Cases, Materials and Text on Contract Law: Ius Commune Casebooks for the Common Law of Europe* 2 ed (2010) 381; EC Melato "Precontractual Liability" in G De Geest (gen ed) C*ontract Law and Economics* 2 ed (2011) 9 12 ; Farnsworth *Contracts* 189-190; MacFarlane 2010 *OUCLJ* 99; T Irakli "The Principles of Freedom of Contract, Pre-Contractual Obligations Legal Review, EU and US Law" (2017) 13 *ESJ* 62 63,67; A Schwartz & RE Scott "Pre-Contractual Liability and Preliminary Agreements" (2007) 120 *Harv L Rev* 661 690; Farnsworth 1987 *Colum LR* 221, 243.

[8] Hutchison 2012 *SALJ* 120; Furmston & Tolhurst *Contract Formation: Law and Practice* 2 ed (2016) 405; Beale et al *Cases, Materials and Text* 372; N Andrews *Contract Law* 2 ed (2015) 22; Cartwright *Contract Law* 74; *Cobbe v Yeoman's Row Management Ltd* [2006] EWCA Civ 1139 para 4; Klass *Contract Law* 98.

[9] Beale et al *Cases, Materials and Text* 372; Van Huyssteen et al *Contract* 85; Furmston & Tolhurst *Contract Formation* 405-406; Hutchison 2012 *SALJ* 118.

[10] E Pannebakker *Letter of Intent in International Contracting* LLD thesis Eramus University Rotterdam (2016)176; Van Huyssteen & Maxwell *Contract Law* paras 191-194.

the law of unjust enrichment, estoppel,[11] and tort.[12] A number of common-law jurisdictions are moving in the direction, familiar to civil-law systems, of imposing greater liability in the pre-contractual phase.[13] This chapter will analyse, with reference to comparative studies, whether South African law can and should follow suit. In this regard, South African law, like common-law systems generally, accepts that the pre-contractual relationship does not warrant legal protection for losses suffered during negotiations.[14] Furthermore, the duty to negotiate in good faith, at present, still allows parties to break off negotiations without incurring liability.[15] This analysis shall consider whether pre-contractual liability can arise in terms of the application of existing legal rules or whether further reform is required, for example by developing constructs similar to the doctrine of *culpa in contrahendo*. The manner in which some legal instruments aimed at harmonisation regulate pre-contractual liability will also be evaluated insofar as it can shape national rules on pre-contractual liability.

5 2 The law of delict or tort

This section will explore the law of delict (which can be generally equated to the law of tort in common-law jurisdictions) as a potential source of liability for compensating losses arising from failed negotiations. While South African law recognises general principles of delict that are "modified" for different actions,[16] common-law systems such as England and America have a closed system of nominate torts that are

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[11] Estoppel will not be considered in this thesis, as it cannot form the basis of a cause of action in South African law. Therefore it is irrelevant to the development of pre-contractual liability in this thesis. In this regard see Hutchison 2012 *SALJ* 115; R Sharrock *Business Transactions Law* 9 ed (2016) 88; Van Huyssteen et al *Contract Law* 198; JC Sonnekus *Law of Estoppel* 3 ed (2012) 30-31.

[12] Andrews *Contract Law* 22; Cartwright *Contract Law* 83; Beale et al *Cases, Materials and Text* 381; Pannebakker *Letters of Intent* 122-123; *Cobbe v Yeoman's Row Management Ltd* [2006] EWCA Civ 1139 para 4; Farnsworth 1987 *Colum LR* 222; Farnsworth *Contracts* 192; A Katz "When Should an Offer Stick - The Economics of Promissory Estoppel in Preliminary Negotiations" (1996) 105 *Yale LJ* 1249 1254; see also 205(c) of the *American Uniform Commercial Code*.

[13] Hutchison 2012 *SALJ* 104; see also MacFarlane 2010 *OUCLJ* 95, who argues that English law is beginning to recognise the need to impose liability for certain pre-contractual conduct.

[14] Van Huyssteen et al *Contract* 85.

[15] Hawthorne & Hutchison "Offer and Acceptance" in *Law of Contract* 63; ch 2; ch 3.

[16] M Loubser & R Midgley (eds) *The Law of Delict in South Africa* 3 ed (2017) 27.

intended to protect specific interests. [17]

It bears mentioning that if a delictual claim were to be recognised for losses suffered during the pre-contractual phase, the remedy would generally be reliance damages, which are aimed at placing the party in the position he would have been in had the delict not been committed.[18] This is distinguishable from expectation damages, which in this context would place the aggrieved party in the position he would have been in had the contract been concluded.

With this in mind, a jurisdiction-specific analysis of the law of delict as a source of pre-contractual liability will be conducted. This analysis shall focus on the extent to which the law of delict or tort can remedy a party's wasted pre-contractual expenditure, particularly where the other party encourages expenditure and misrepresents his intention to conclude the contract.

5 2 1 English law

In English law, the mere breaking off of negotiations does not constitute a tort.[19] For pre-contractual liability to arise the conduct must fit into one of the existing categories of torts.[20] This is not the only difficulty; claims for pre-contractual expenses are generally for pure economic loss and English courts have been unwilling to grant claims for pure economic loss for fear of opening the floodgates of litigation in respect of an indeterminate class of claimants for an indeterminate amount.[21]

Nevertheless, in *Walford v Miles*[22] ("*Walford*") the court opened the possibility for pre-contractual liability when it confirmed that parties are entitled to pursue their own

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[17] Giliker *Pre-Contractual Liability* 106; Cartwright *Contract Law* 81, 84; Pannebakker *Letter of Intent* 123; CC Tilley "Tort Law Inside Out" (2017) 126 *Yale LJ* 1320 1341.

[18] Hutchison 2012 *SALJ* 114-115; Loubser & Midgley (eds) *Law of Delict* 486-488; Pannebakker *Letter of Intent* 146-147, 197; Cartwright *Contract Law* 85-86; Farnsworth 1987 *Colum LR* 224; B Tremml "The Acquisition of Closely Held Companies" in M Wendler, B Tremml & B Beucker (eds) *Key Aspects of German Business Law: A Practical Manual* (2008) 39 42; XY Li "The Legal Status of Pre-Contractual Liability: Contrasting Responses from German and English law" (2017) 12 *NTU L Rev* 127 132-133.

[19] Cartwright *Contract Law* 81.

[20] Giliker *Pre-Contractual Liability* 106.

[21] P Giliker "A role for tort in pre-contractual negotiations? An examination of English, French and Canadian law" (2003) 52 *ICLQ* 969 - 994.

[22] [1992] 2 AC 128 138.

interests as long as they avoid making misrepresentations.[23] In this case the court found that agreements to negotiate are unenforceable due to uncertainty, but nevertheless awarded damages for misrepresentation. The court concluded that Mr and Mrs Walford made a misrepresentation to Mr Miles that they were no longer negotiating with third parties for the sale of their business which was relied upon by Mr Miles to his detriment.[24] The court therefore awarded Mr Miles his reliance damages.[25] Pre-contractual liability will be imposed for a misrepresentation if it amounts to a tort of deceit or negligence.[26] Misrepresentations may either induce contract conclusion, or give rise to reliance that a contract will materialise and it does not.[27] Most pre-contractual losses arise from the former misrepresentation.[28] However, this chapter will focus on pre-contractual losses suffered by a party due to reliance on another party's misrepresentation regarding the latter's intention to conclude a contract.[29] It will become apparent, as we now turn to the requirements for these torts, that they are not ideally suited to pre-contractual claims.[30]

5 2 1 1 General requirements for misrepresentation to give rise to liability in tort

Before proceeding to the requirements distinct to the tort of deceit and negligence respectively, we shall first consider the general requirements for an actionable misrepresentation, namely a false statement of fact that has been relied upon.[31]

Misrepresentations regarding contract conclusion[32] were traditionally not regarded

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[23] Hutchison 2012 *SALJ* 121; J Beatson, AS Burrows & J Cartwright *Anson's Law of Contract* 30 ed (2016) 26; S Whittaker "Introductory" in HG Beale (gen ed) *Chitty on Contracts I: General Principles* 32 ed (2015) 3 128; Cartwright *Contract Law* 81; Pannebakker *Letter of Intent* 123.

[24] [1992] 2 AC 128 136B.

[25] 136B.

[26] Giliker *Pre-Contractual Liability* 106; Furmston & Tolhurst *Contract Formation* 406; Cartwright *Contract Law* 84; Pannebakker *Letter of Intent* 123.

[27] Giliker *Pre-Contractual Liability* 106; Furmston & Tolhurst *Contract Formation* 406; Cartwright *Contract Law* 84; Pannebakker *Letter of Intent* 123.

[28] Cartwright *Contract Law* 84; J Cartwright & M Hesselink (eds) *Precontractual Liability in European Private Law* (2008) 94.

[29] Cartwright *Contract Law* 84; McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 191.

[30] Giliker *Pre-Contractual Liability* 106; Pannebakker Letter of *Intent* 123.

[31] HG Beale "Misrepresentation" in HG Beale (gen ed) *Chitty on Contracts I: General Principles* 32 ed (2015) 647; Giliker *Pre-Contractual Liability* 109; Andrews *Contract Law* 222.

[32] Giliker *Pre-Contractual Liability* 110.

as statements of fact but rather as statements of future intent or opinion.[33] However, this position is changing as courts opt for a more lenient test to establish whether a representation is a statement of fact. Under this more flexible test, a representation that a contract will be concluded can be interpreted as a statement of fact regarding a party's present state of mind and intention to continue with negotiations.[34]

In *Esso Petroleum Co Ltd v Mardon*[35] ("*Esso Petroleum*") the court further developed this test, when it confirmed that what would otherwise be a statement of opinion may be construed as one of fact where it is made by a party possessing "superior knowledge or skill".[36] Although this case concerned a misrepresentation inducing contract conclusion, it set a valuable precedent for future development of pre-contractual liability.[37]

The second requirement is that the aggrieved party must have relied upon the defendant's statement to his detriment.[38] This means that the misrepresentation must have had a "decisive influence" on the aggrieved party's conduct.[39] With this in mind, we will now consider the requirements for the tort of deceit and negligence respectively.

5 2 1 2 Tort of deceit

A person may be held liable in the tort of deceit for wasted expenditure incurred by another in reliance on the former's fraudulent misrepresentation regarding his intention to conclude the anticipated contract.[40] In *Derry v Peek*[41] the court explained the requirements:

"fraud is proved when it is shown that a false representation has been made (1) knowingly,

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[33] 110.

[34] 110.

[35] [1976] QB 801 (CA).

[36] Giliker *Pre-Contractual Liability* 110.

[37] Giliker *Pre-Contractual Liability* 110; Cartwright *Contract Law* 82; see *Box v Midland Bank* [1979] 2 Lloyd's Report 391; See ch 5 (5 2 1 3).

[38] Giliker *Pre-Contractual Liability* 110; Pannebakker *Letter of Intent* 124; Cartwright *Contract Law* 84-85.

[39] Pannebakker *Letter of Intent* 124.

[40] Cartwright *Contract Law* 84; Pannebakker *Letter of Intent* 124; *Walford v Miles* [1992] 2 AC 128 (HL) 138.

[41] (1889) 14 AC 337 (HL) 374.

or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false".[42]

The evidentiary burden on the claimant to prove the defendant's fraudulent intention makes it difficult to succeed with this action.[43] While an action theoretically lies, in practice the tort of deceit is not a realistic source of pre-contractual liability.

5 2 1 3 Tort of negligence

As previously mentioned, courts have been hesitant to grant claims for pure economic loss.[44] Nevertheless, in the seminal case of *Hedley Byrne & Co v Heller & Partners*[45] the court recognised a claim for pure economic loss caused by a negligent misrepresentation.[46] The requirements are as follows: there must be a duty of care between the claimant and defendant, which the latter failed to comply with, and as a result of which the former suffered loss.[47]

In contrast with civil-law systems such as Germany, English law does not recognise a duty of care upon the commencement of negotiations.[48] This presents difficulties to a party claiming pre-contractual losses.[49] A duty of care will only arise when there is a special relationship of proximity.[50] The court in *Hedley*[51] explains that a duty of care exists if a person "takes it upon himself to give information or advice" to another and knew or ought to have known that the other party would rely upon it.[52] There must be some form of assumption of responsibility on the part of the defendant.[53]

In *Box v Midland Bank*[54] a bank manager made a representation that the approval

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[42] See also discussion in Cartwright *Contract Law* 85.

[43] Hutchison 2012 *SALJ* 121.

[44] Giliker 2003 *ICLQ* 974; Beale *Cases, Materials and Text* 388; Giliker *Pre-Contractual Liability* 102, 108.

[45] [1964] AC 465 (HL).

[46] 509.

[47] Cartwright *Contract Law* 85.

[48] Cartwright *Contract Law* 82; Pannebakker *Letter of Intent* 125; Li 2017 *NTU L Rev* 150.

[49] Giliker *Pre-Contractual Liability* 118.

[50] Giliker *Pre-Contractual Liability* 109; Pannebakker *Letter of Intent* 125; see *Anss v Merton LBC* [1978] AC 728 (HL) 751-752 which also sets out the requirements for a special relationship to exist.

[51] [1964] AC 465 (HL) 509.

[52] *Hedley Byrne & Co v Heller & Partners* [1964] AC 465 (HL) 509; Cartwright *Contract Law* 85; Pannebakker *Letter of Intent* 125.

[53] [1964] AC 465 (HL) 483.

[54] [1979] 2 Lloyd's Report 391.

of the claimant's application by the head office was a formality, but his application was subsequently rejected. Lloyd J, relying on *Esso Petroleum,* concluded that the bank manager's representation was a statement of fact regarding the bank's present applications policy.[55] This case recognised liability for negligent misrepresentations regarding the likely outcome of negotiations.[56] In theory, this decision extended liability for negligent misrepresentation into the pre-contractual phase,[57] but this lone precedent has not been followed in subsequent case law. It is thus unlikely that a party will establish a duty of care in the course of contractual negotiations.[58]

Giliker proposes that English tort should be developed in a similar manner to the French law of tort which allows claims for these types of pre-contractual losses. [59] She nevertheless concedes that there is little scope for development due to the extremely restrictive approach to claims for pure economic loss, the importance attributed to freedom of contract[60] and the deeply entrenched notion that there is no liability prior to contract formation. For now, it is accepted that a claimant must resort to other potential sources of pre-contractual liability.

5 2 1 4 Misappropriation of confidential information

Various legal mechanisms are aimed at protecting a party who discloses confidential information during contractual negotiations.[61] It can potentially be argued that misappropriation of confidential information constitutes a tort,[62] if such information was recognised as property.[63] This tort has yet to be recognised and the prevailing view seems to be that an obligation for breach of confidence arises either from contract or

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[55] 399.

[56] M Chen-Wishart "The Agreement"in HG Beale (gen ed) *Chitty on Contracts I: General Principles* 32 ed (2015) 334.

[57] Giliker *Pre-Contractual Liability* 111.

[58] McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 190; Giliker *Pre-Contractual Liability* 118-119.

[59]2003 *ICLQ* 978-981.

[60] 978.

[61] P Cane *The Anatomy of Tort Law* (1997) 80.

[62] 80

[63] 80.

some "'equitable' idea of 'trust'".[64] Although there is currently no claim in tort,[65] we will nevertheless consider the duty of confidence arising in equity.[66]

This equitable duty developed to prevent parties from utilising confidential information for any other purpose than that for which it is disclosed.[67] In the leading case of *Seagar v Copydex*[68] ("*Seagar*"), the court confirmed that there is an equitable duty on a party who has received confidential information not to take "unfair advantage of it." In *Terrapin Ltd v Builders Supply Co (Hayes) Ltd*[69] ("*Terrapin*") the court explained that a person is not allowed to use confidential information "as a springboard for activities detrimental to the person" disclosing such information.

An aggrieved party will therefore have a claim for the misuse of confidential information disclosed in the course of negotiations if an equitable duty of confidentiality arises, bearing in mind that it is within the discretion of the court to determine whether a duty of confidentiality arises during negotiations.[70]

5 2 2 American law

Most American jurisdictions do not recognise liability, in tort, for negligent misrepresentations made during failed negotiations.[71] Pre-contractual liability in tort may arise for the misappropriation of trade secrets, interference with a prospective contractual relationship[72] or fraudulent misrepresentations. [73]

Section 530(1) of the Restatement (Second) of Torts provides that a "representation of the maker's own intention to do or not to do a particular thing is fraudulent if he does

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[64] 80.

[65] For an exception, see *Douglas and another and others v Hello! Limited and others* [2007] UKHL 21 where it was found that there may be liability in tort to protect commercial confidence.

[66] Cartwright *Contract Law* 94.

[67] Pannebakker *Letter of Intent* 127.

[68] [1967] 1 WLR 923 (EWCA) 931.

[69] 1960 RPC 128 (CA).

[70] Pannebakker *Letter of Intent* 128*;* see e.g. *James Industries Ltd's patent* [1987] RPC 235 (PO) 235.

[71] Farnsworth 1987 *Colum LR* 233; *Restatement (Second) of Torts* sec 552; Hutchison 2012 *SALJ* 122. For further discussion of negligent misrepresentations see RE Scott "*Hoffman V Red Owl Stores* and the Myth of Precontractual Reliance" (2007) 68 *Ohio ST LJ* 71 92.

[72] This liability remains relatively undeveloped. DC Turack "Pre-Contractual Liability in the United States of America: A National Report" (1990) 38 *Am J Comp L* 115 119, JM Creed "Integrating Preliminary Agreements into the Interference Torts" (2010) 110 *Colum LR* 1253 1256, 1289-1290.

[73] Pannebakker *Letter of Intent* 176.

not have that intention". A party may thus be liable if he continues negotiations without seriously intending to reach agreement or negotiates with a party solely to prevent him from contracting with a third party.[74]

To succeed with a claim in tort, the aggrieved party must prove there was a false misrepresentation made with fraudulent intent, and knowledge of falsity, that was reasonably relied upon and caused damage.[75] Proving fraudulent intent is particularly difficult, because it requires an assessment of the party's state of mind.[76] There is thus little case law on this type of claim.[77]

Markov v ABC Transfer and Storage Co[78] constitutes an exceptional case where a claim for fraudulent misrepresentation was successful. The lessor made representations to the lessee regarding its intention to renew the lease while simultaneously negotiating and eventually selling the leased premises to third parties.[79] The court found that the lessor's true intent was clearly to keep its options open to its own benefit.[80] The representations were fraudulent because they were made "without care or concern" as to whether they would be kept.[81]

The court granted the aggrieved party his reliance damages, which in these specific circumstances included a claim for the lost opportunity to fulfil its services to its main client.[82] This case remains highly exceptional and the tort of deceit is rarely applied by the courts in this context.[83]

Farnsworth explains that the tort of deceit has not become a prominent source of pre-contractual liability, primarily because parties are rarely inclined to make the types of blatantly false misrepresentations dealt with in *Markov*,[84] and it is thus difficult to

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[74] Pannebakker *Letter of Intent* 176-177; Farnsworth 1987 *Colum LR* 234; Farnsworth *Contract* 196.

[75] WL Prosser *Law of Tort* 4 ed (1971) 728; Pannebakker *Letter of Intent* 177. See also e.g. *Space Imaging Europe, Ltd. v. Space Imaging L.P* (1999) 8 F. Supp. 2d 326, 338 (S D N Y).

[76] Pannebakker *Letter of Intent* 177; Farnsworth 1987 *Colum LR* 233-234.

[77] Pannebakker *Letter of Intent* 176; Farnsworth 1987 *Colum LR* 233-234; Farnsworth *Contracts* 194.

[78] (1969) 76 Wash 2d 388.

[79] 392-393.

[80] 397.

[81] 396.

[82] 395,397.

[83] Farnsworth 1987 *Colum LR* 235; Farnsworth *Contracts* 195.

[84] 195.

prove fraudulent intent.[85] From this analysis it becomes clear that while American law does recognise a claim in tort for fraudulent misrepresentation, it is not regarded as a practical or promising source of liability.

5 2 3 German law

In Germany, pre-contractual liability is well developed. Scholars and courts recognised that the German law of delict was an unsuitable source of pre-contractual liability, because it excluded claims for negligently caused pure economic loss[86] To address this they developed the doctrine of *culpa in contrahendo*,[87] a unique form of liability with both delictual and contractual elements.[88]

5 2 3 1 Culpa in contrahendo

Culpa in contrahendo, as formulated in the pioneering nineteenth-century study of Von Jhering and Demelius,[89] envisaged liability for blameworthy conduct during the pre-contractual phase that renders the contract invalid or void.[90] Over time case law and legal literature aided the further development of *culpa in contrahendo* to apply to failed

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[85] 196.

[86] F Kessler & E Fine "*Culpa in Contrahendo*, *Bargaining in Good Faith and Freedom of Contract*" (1964) 77 *Harv L Rev* 401 406; AT Von Mehren "The Formation of Contracts" in *International Encyclopedia of Comparative Law VII - Contracts in General* (2008) para 121; B Markesinis, H Unberath & A Johnston *The German Law of Contract: A Comparative Treatise* 2 ed (2006) 99.

[87] Kessler & Fine 1964 *Harv L Rev* 406; McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 187; Markesinis et al *The German Law of Contract* 93-94; Li 2017 *NTU L Rev* 137; J Cardenas "Deal Jumping in Cross-Border Merger & Acquisition Negotiations: A Comparative Analysis of Pre-Contractual Liability Under French, German, United Kingdom and United States law" (2013) 9 *NYU JL & Bus* 941 964-965.

[88] Hutchison 2012 *SALJ* 117; R Zimmermann *The Law of Obligations – Roman Foundations of the Civilian Tradition* (1996) 245; Markesinis et al *German Law of Contract* 92; J Dietrich "Classifying Precontractual Liability: A Comparative Analysis" (2001) 21 *Legal Stud* 153 175.

[89] R Von Jhering & G Demelius "Culpa in contrahendo, oder Schadensersatz bei nichtigen oder nicht zur Perfektion gelangten Verträgen" in R Von Jhering (gen ed) *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Privatrechts* vol 4 (1861). See also the discussion in U Draetta & RB Lake "Letters of Intent and Pre-Contractual Liability" 1993 *Int'l Bus LJ* 835 851- 852; Kessler & Fine 1964 *Harv L Rev* 402-403.

[90] Kessler & Fine 1964 *Harv L Rev* 401 402; Markesinis et al *German Law of Contract* 92; Farnsworth 1987 *Colum LR* 240; NE Nedzel "A Comparative Study of Good Faith, Fair Dealing, and Pre-Contractual Liability" (1997) 12 *Tul Eur & Cil LF* 97 144.

negotiations.[91] The focus of the doctrine also shifted from merely protecting reliance to promoting good faith in contract formation.[92]

Since the seminal "*Linoleum Carpet Case*"[93] German courts have accepted that parties to contractual negotiations are in a relationship akin to a contractual one and therefore liability can arise if a party does not respect the legitimate interests and expectations of the other party.[94] Case law confirms that the commencement of negotiations gives rise to a duty of care.[95]

*Culpa in contrah*endo was incorporated in the more recent reforms of the German Civil Code or *Bürgerliches Gesetzbuch* ("BGB").[96] Section 241(2) BGB provides for "an obligation … to take account of the rights, legal interests and other interests of the other party". Section 311(2) BGB provides that the duties set out in section 241(2) BGB can arise from the "commencement of contractual negotiations", or if one party to a potential contractual relationship has given the other party the ability to affect his rights or legal interests.

Markesinis and others describe this codification of *culpa in contrahendo* as "utterly vague" and argue that the legal position should be understood with reference to existing case law until the courts provide further clarification.[97]

5 2 3 2 Practical application

There are three elements to succeed with a claim for *culpa in contrahendo* where negotiations fail to result in contract conclusion.

> "First, one party must have led the other to believe that conclusion of the contract was certain. Secondly, that expense was incurred in view of the contract. Finally, that

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[91] Kessler & Fine 1964 *Harv L* 404.

[92] Li 2017 *NTU L Rev* 139; Kessler & Fine 1964 *Harv L Rev* 403-404.

[93] For discussion of this case, see Babusiaux "Art 2:302: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 354.

[94] 354.

[95] See cases cited in Kessler & Fine 1964 *Harv L Rev* 404 fn 10. See also Cardenas 2013 *NYU JL & Bus* 969, LE Trakman and K Sharma "The Binding Force of Agreements to Negotiate in Good Faith" (2014) 73 *CLJ* 598 608-609, Draetta & Lake 1993 *Int'l Bus LJ* 852, C Kunze *The Letter of Intent, with Special Emphasis on its Relevance in International Trade Law* unpublished LLM Mini thesis Stellenbosch University (2014) 27.

[96] See 241(2) BGB and 311(2) BGB; M Hogg *Promises and Contract Law*: *Comparative Perspectives* (2011) 190; Li 2017 *NTU L Rev* 132; Cardenas 2013 *NYU JL & Bus* 963.

[97] *German Law of Contract* 93.

subsequently the other party broke off the negotiations without good reason."[98]

Various cases during the 1950s confirmed that liability ensues if a party carelessly induced the other party to believe that a contract would be concluded.[99] In one case[100] it was confirmed that even without prior carelessness a party can be held liable for inducing reliance that a contract will materialise if negotiations are broken off without a valid reason.[101] This was confirmed in the "Newspaper"[102] decision, where it was also added that the claimant must show the defendant "had induced the belief that the contract would, with certainty, be finalized."[103] Some authors suggest this sets a higher threshold for the imposition of liability than the common-law "legitimate expectation" requirement.[104] The claimant must also prove he relied on the anticipated materialisation of the contract to his detriment.[105]

We now turn to the third and problematic element: what constitutes a "good reason" to break off negotiations?[106] Courts have yet to provide clarity on this issue.[107] Dietrich suggests that the grounds justifying rescission of a contract will also constitute good reason for breaking off contractual negotiations.[108] Good reason will also exist if the negotiations were terminated pursuant to an impediment such as inability to perform

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[98] 100. The authors derive these requirements from the following cases: BGH *WM* 1969, 595; BGH *NJW* 1975, 1774; BGH *NJW-RR* 1989, 627. See also Cardenas 2013 *NYU JL & Bus* 966.

[99] G Kuhne "Reliance,Promissory Estoppel and Culpa in Contrahendo: A Comparative Analysis" (1990) 10 *Tel Aviv U Stud L* 279 285.

[100] *Wertpapier-Mitteilungen* 595 (1969).

[101] Kuhne 1990 *Tel Aviv U Stud L* 286.

[102] BGH *JZ* 46, 199 (1989-02-22).

[103] Dietrich 2001 *Legal Stud* 181.

[104] Dietrich 2001 *Legal Stud* 178,181; Hogg *Promises and Contract Law* 193; Von Mehren "Formation of Contract" in *International Encyclopedia* para 121.

[105] N Bass "Eleventh Hour Collapse: An Elements-Based Comparison of the German Doctrine of Culpa in Contrahendo and Australian Principles of Pre-Contractual Liability" (2009) 6 *Macquarie J Bus L* 217 223; M Tegethoff "Culpa in Contrahendo in German and Dutch Law – A comparison of Precontractual liability" (1998) 5 *Maastricht J Eur & Com L* 341 359;

[106] Markesinis et al *German Law of Contract* 101; Von Mehren "Formation of Contract" in *International Encyclopedia* para 121.

[107] Markesinis et al *German Law of Contract* 101; Von Mehren "Formation of Contract" in *International Encyclopedia* para 122.

[108] 2001 *Legal Stud* 179, citing H Koziol Ö*sterreichisches Haftpflichtrecht* II (1980) 78.

on the claimant's part.[109]

From the above analysis it is clear that it is not the breaking off of negotiations that give rises to liability, but the blameworthy manner in which negotiations were conducted prior to termination.[110] German courts do not positively enforce the duty to negotiate in good faith, but rather grant reliance damages to compensate the aggrieved party.[111] Specific performance is thus unavailable during the pre-contractual phase.[112]

Whether the German doctrine of *culpa in contrahendo* should be imported into South African law will depend on our analysis of the law of delict below.[113] Zieff has strongly advocated the adoption of the doctrine of *culpa in contrahendo* to address the shortcomings of the law of contract and delict relating to negligent misrepresentations.[114] He argued that a remedy was needed "to cater for negligent misrepresentation" and to overcome the obstacles that arise in relation to wrongfulness, pure economic loss and indeterminate liability.[115] This view will be considered when evaluating the law of delict as a source of pre-contractual liability.[116]

5 2 3 3 Duty not to misappropriate confidential information

The German doctrine of *culpa in contrahendo* also protects confidential information disclosed in the course of negotiations.[117] Liability will depend on whether there was an "implied pre-contractual duty" on a negotiating party not to disclose confidential

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[109] Dietrich 2001 *Legal Stud* 179; Cardenas 2013 *NYU JL & Bus* 967.

[110] Markesinis et al *German Law of Contract* 101; Kessler & Fine 1964 *Harv L Rev* 404 referring to case RGZ 143, 124 (1934-01-19). Hogg *Promises and Contract Law* 193; BGH *WM* 1969, 595; Von Mehren "Formation of Contract" in *International Encyclopedia* para 121; Dietrich 2001 *Legal Stud* 178; Kuhne 1990 *Tel Aviv U Stud L* 288.

[111] 280 BGB; see discussion of Markesinis et al *German Law of Contract* 99-100; Cardenas 2013 *NYU JL & Bus* 963-964,966; Dietrich 2001 *Legal Stud* 179.

[112] Cardenas 2013 *NYU JL & Bus* 966; Dietrich 2001 *Legal Stud* 179; Bass 2009 *Macquarie J Bus L* 217 223.

[113] See ch 5 (5 2 4).

[114] "Culpa in Contrahendo: A Prescription for the Ills of the South African Law of Contract" (1989) 52 *THRHR* 348 352.

[115] 352.

[116] 5 2 4

[117] Li 2017 *NTU L Rev* 138 - 139.

information revealed during negotiations.[118] This duty arises as part of the broader duty of care imposed upon parties at the commencement of negotiations.[119] Liability thus flows from sections 311(2) and 280(1) BGB.[120] If a party breaches such duty of confidentiality, the aggrieved party will be entitled to claim damages for the losses suffered,[121] or the benefit or profits received by the other party.[122]

5 2 4 South African law

Comparative analysis reveals that in the foreign common-law systems under consideration the law of tort has a limited application in the pre-contractual phase. This mainly stems from the courts' apprehension towards claims for pure economic loss, which risk opening the floodgates of litigation.[123] Although the floodgates argument is well-known in South African case law and literature, delictual claims for pure economic loss are nevertheless recognised.[124] This allows a claim in delict to potentially lie for the misuse of information disclosed in the course of negotiations and misrepresentations regarding contract conclusion.[125] Delictual liability for misrepresentations that induce contract conclusion is well developed. However, here the focus will be on situations where there is a misrepresentation regarding the conclusion of a contract in circumstances where no contract materialises.[126]

5 2 4 1 Misrepresentations

Before there can be delictual pre-contractual liability, a party must prove the five elements of a delict namely, conduct, harm, causation, fault and wrongfulness.[127] It

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[118] Babusiaux "Art 2:302: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 377.

[119] XY Li 2017 *NTU L Rev* 150; Cartwright & Hesselink *Precontractual Liability* 345-346.

[120] Markesinis et al *German Law of Contract* 96; Cartwright & Hesselink *Precontractual Liability* 345.

[121] XY Li 2017 *NTU L Rev* 134

[122] Babusiaux "Art 2:302: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 382; Cartwright & Hesselink *Precontractual Liability* 346.

[123] See ch 5 (5 2 4, 5 2 1 1, 5 2 2 & 5 2 3).

[124] Loubser & Midgley (eds) *Law of Delict* 274; Hutchison 2012 *SALJ* 124; *Trustee, Two Oceans Aquarium Trust v Kantey & Templer (Pty) Ltd* 2006 3 SA 138 (SCA).

[125] Van Huyssteen et al *Contract* 87.

[126] Van Huyssteen et al *Contract* 87; Hutchison 2012 *SALJ* 124; see e.g. *Administrateur, Natal v Trust Bank van Afrika Bpk* 1979 3 SA 824A; *Bayer South Africa (Pty) Ltd v Frost* 1991 4 SA 559 (A).

[127] J Neethling, JM Potgieter & PJ Visser *Law of Delict* 7 ed (2015) 307; Hutchison 2012 *SALJ* 126.

will be less problematic to prove the aforementioned elements in respect of fraudulent misrepresentations, even in circumstances where no contract materialises.[128] It is prima facie wrongful for one party to continue negotiations knowing that he does not intend to conclude a contract and a claim in delict will likely lie for the aggrieved party.[129] However, proving fraud is exceedingly difficult; the true challenge in practice is to determine what the consequences of negligent behaviour would be. In this regard *Murray v McLean NO*[130] ("*Murray*") is the only case to consider the existence of an action for pure economic loss arising from a negligent misrepresentation made in the course of failed negotiations. Although it set the precedent that no such cause of action exists in the law of the former Rhodesia (now Zimbabwe) or South Africa,[131] some academics argue that this case no longer reflects the current legal position and requires reconsideration.[132] To recognise such an action, liability for negligent misrepresentations would have to be extended to include the situation where the misrepresentation does not induce contract conclusion, but rather induces a detrimental reliance that a contract will be concluded.[133] In order to evaluate the possibility of such a development it is necessary to analyse the merits of the *Murray*[134] case.

(i) The precedent set by *Murray v McLean NO*

Here the defendant, made various representations regarding the purchase of prefabricated houses from the claimant, and the availability of funds to do so.[135] Both parties anticipated contract conclusion, and the claimant's reliance expenditure was wasted when the defendant decided against the transaction.[136]

The court confirmed that in limited circumstances our law is willing to impose

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[128] Hutchison 2012 *SALJ* 124, 127; *Meskin v Anglo American Corporation of SA Ltd* 1968 4 SA 793 (W) 802-804.

[129] Van Huyssteen & Maxwell *Contract Law* paras 191-194; Hutchison 2012 *SALJ* 124.

[130] 1970 1 SA 133 (R).

[131] Hutchison 2012 *SALJ* 125.

[132] Van Huyssteen et al *Contract* 88; Hutchison 2012 *SALJ* 125.

[133] Hutchison 2012 *SALJ* 124 - 125.

[134] 1970 1 SA 133 (R).

[135] 134-135.

[136] 135-136,138.

delictual liability for negligent misrepresentations.[137] Lewis J proceeded to list the two essential requirements for this type of claim with reference to *Herschel v Mrupe*.[138] These requirements are first that the claimant must have had a right to rely on the representation, and secondly that he must have exercised ordinary care in protecting his own interests.[139] Lewis J went on to find that the claimant did not have "the right to gamble on the fact that a contract might eventuate and then seek to hold the representor responsible when no contract eventuates".[140]

The court explained that an ordinary person in this situation would either have avoided incurring expenses until contract conclusion or would have sought to protect himself in the course of negotiations by concluding a separate agreement regulating the allocation of risk in the pre-contractual phase.[141] The latter sentiment is supported with reference to the similar reasoning of Wessels JA in *Hamman v Moolman*.[142]

The court further regarded the possibility of an action for negligent misrepresentation in the circumstances of the case as a "startling innovation in commercial affairs".[143] Parties to contractual negotiations are "deemed to know that there is a risk" that the contract will not materialise.[144] In this regard, Lewis J, by way of illustration, gave the example of a lady who goes into a shoe shop to purchase a pair of shoes, despite lacking the funds to do so.[145] By choosing to help the lady, the shopkeeper takes a commercial risk and will have no action against her if no sale is concluded.[146] This despite the lady making an implied representation that she had funds to purchase the shoes, and the shopkeeper wasting time she could have spent securing a now lost sale from another customer. [147]

Lewis J ultimately concluded that the claimant had failed to disclose a cause of

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[137] 136.
[138] 1954 3 SA 464 (A).
[139] 1970 1 SA 133 (R) 138.
[140] 138.
[141] 138-139.
[142] 1968 4 SA 340 (A) 348.
[143] *Murray v McLean* NO 1970 1 SA 133 137.
[144] 137-138.
[145] 138.
[146] 138.
[147] 138.

action.[148] Much of the reasoning in this judgement suggests that he considered the claimant's reliance to be unreasonable.[149] His reasoning was also strongly influenced by the fact that at that time, negligently-caused pure economic loss did not give rise to a delictual cause of action.[150]

(ii) Potential development

The *Murray* precedent must be rejected insofar as it was justified by the denial of claims for pure economic loss, since these claims are now recognised in South African law. [151] The question rather arises whether Lewis J raised other valid reasons to deny this action. This brings us to the lady in the shoe shop example.[152] While it is indeed true that the shopkeeper should not have a claim against a customer, the extension of this reasoning to complex commercial transactions constitutes a sweeping generalisation and oversimplification of transactions that require a party to expend substantial resources in preparation for contract conclusion. Such transactions often see parties making relationship-specific investments in reliance on a representation at an advanced stage of negotiations where the contract is likely to materialise. Business professionals often conduct business informally under a mutual expectation that parties may rely upon representations and assurances made during contractual negotiations even in the absence of an agreement to that effect. This is clearly distinguishable from the former situation where the shopkeeper is well aware that their time may be wasted if a lady lacks the necessary funds, or does not find what she is looking for.

Lewis J's suggestion that parties should conclude an ancillary contract regulating the allocation of risk ignores the reality that commercial parties are unlikely to expend time and resources on negotiating such a contract, as a precaution to prepare for the worst case scenario, particularly when negotiations are going well. It does not follow that a party should be allowed to create a reasonable expectation that a contract will materialise, knowing that the other party is relying upon it, and then break off

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[148] 1970 1 SA 133 (R) 142.

[149] Hutchison 2012 *SALJ* 125.

[150] See *Herschel v Mrupe* 1954 3 SA 464 (A) and *Hamman v Moolman* 1968 4 SA 340 (A) which were cited by Lewis J in support of this conclusion.

[151] Hutchison 2012 *SALJ* 125-126.

[152] See ch 5 (5 2 4 1(i)).

negotiations in bad faith. In the absence of liability, parties will be wary of conducting negotiations. This potentially stifles economic growth and the efficiency of business transactions.

If the *Murray* case is no longer good in law, can and should this claim be recognised? The fact that our law has developed to recognise actions for negligent misrepresentation(s) inducing contract conclusion[153] supports the possibility of developing a similar action where no contract materialises.[154] Our discussion now turns to whether the latter claim meets the elements of a delict. In this regard, the primary focus will be on the most problematic element namely wrongfulness.[155]

It is clear that intentional harm-causing is prima facie wrongful, but the same is not true of negligent conduct.[156] To prove wrongfulness there must be "infringement of a right or breach of a duty".[157] In most cases the focus will be on whether there was a legal duty on the defendant to ensure that the claimant does not suffer economic losses.[158] In *Olitzki Property Holdings v State Tender Board*[159] the court explained that whether a legal duty exists involves a value judgment "as to whether the claimant's invaded interest is worthy of protection against the kind conduct perpetrated by the defendant".[160]

The wrongfulness test applies "a general criterion of reasonableness, based on considerations of morality and policy, and taking into account its assessment of the legal convictions of the community and now also taking into account the norms, values and principles contained in the Constitution".[161] As a result, the wrongfulness test has become more flexible and open-ended.[162]

In this context the wrongfulness enquiry must take into account the fundamental

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[153] See *Bayer South Africa (Pty) Ltd v Frost* 1991 4 SA 559 (A); *Administrateur, Natal v Trust Bank van Afrika Bpk* 1979 3 SA 824A.

[154] Hutchison 2012 *SALJ* 127-128;

[155] Neethling et al *Law of Delict* 307; Hutchison 2012 *SALJ* 126.

[156] Loubser & Midgley *Law of Delict* 275; *Telematrix (Pty) Ltd v Advertising Standards Authority* 2006 1 SA 461 (SCA) para 13.

[157] Loubser & Midley *Law of Delict* 276; Neethling et al *Law of Delict* 307.

[158] Loubser & Midley *Law of Delict* 276; Neethling et al *Law of Delict* 307.

[159] 2001 3 SA 1247 para 11.

[160] Para 11.

[161] Para 11 (footnotes omitted).

[162] Van Huyssteen et al *Contract* 88.

importance attached to freedom of contract and the right to break off negotiations without liability, making the action less likely to succeed.[163] It is also relevant that the traditional allocation of risk prior to contract formation will be disrupted by the imposition of liability.[164] Nevertheless, there are public policy considerations that favour the extension of delictual liability for pre-contractual conduct. Public policy has seen a shift towards greater fairness and reasonableness in contracting[165] , and more specifically the need to promote the value of good faith.[166] We observed above that German law recognises that specific duties arise upon the commencement of negotiations which requires parties to consider each other's interests.[167] Du Plessis explains that these pre-contractual duties exist in German law to give expression "to good faith as an underlying value".[168] By extension it can be argued that good faith as an underlying value would best be given effect to by developing the law of delict to make provision for blameworthy conduct in the course of contractual negotiations. The blanket denial of an action for pre-contractual misrepresentations where no contract materialises is inconsistent with this shift. The law must be developed to meet modern commercial needs.[169] This action should be recognised, albeit in a carefully constructed and qualified way to avoid opening the floodgates of litigation.

Actionable misrepresentations regarding future contract conclusion must be delineated from innocent, good faith representations. Wrongfulness will play a crucial role here. Hutchison correctly argues that breaking off negotiations will only be wrongful if the misrepresentation induces a legitimate expectation that a contract will be concluded.[170] This in turn depends on the stage of negotiations reached.[171]

McFarlane, writing in the context of English law, similarly suggests that this claim should only be available if there is a reasonable reliance and negotiations have

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[163] Hutchison 2012 *SALJ* 126.

[164] 129.

[165] Hutchison 2012 *SALJ* 129-130; *Barkhuizen v Napier* 2007 5 SA 323 (CC).

[166] Van Huyssteen et al *Contract* 85;

[167] See ch 5 (5 2 3).

[168] "Giving Practical Effect to Good Faith in the Law of Contract" (2018) 18 *Stell LR* 379 387.

[169] Van Huyssteen et al *Contract* 91; Hutchison 2012 *SALJ* 129.

[170] Hutchison 2012 *SALJ* 129-131; Neethling et al *Law of Delict* 318-319.

[171] See Fine & Kezzler 1964 *Harv L Rev* 412 who discuss a similar position in German law.

reached a stage where there is an "agreement in principle".[172] If negotiations are advanced it is more likely that a contract will be concluded, and thus the reliance is reasonable.[173] In this regard a comparison can be drawn with the requirements for liability to arise on the basis of the doctrine of *culpa in contrahendo*,[174] where it is required that one party must have led the other party to believe that conclusion of the contract was certain. If all of the above requirements are met, a legal duty of care should arise to prevent harm to the other party.

Public policy considerations dictate that the aggrieved party be compensated for his reliance expenditure. This way parties may claim their reliance losses in the appropriate circumstances and ensuring that freedom of contract is for the most part respected[175] and the floodgates of litigation are not opened This proposed solution conforms to the position in the international instruments[176] and in German law.[177]

Finally, as indicated earlier, Zieff has argued that a single unified remedy, in the form of *culpa in contrahendo*, should be adopted into South African law.[178] However, while there are merits to his argument, they have to be considered in the context of the time in which they were made. The law of delict has seen substantial development since then, and it is therefore proposed that pre-contractual liability for negligent misrepresentations can be provided for, without having to import the doctrine of *culpa in contrahendo*. In any event, it will be very difficult for courts to introduce *culpa in contrahendo* into South African law given the doctrine of precedent and the absence of case law in favour of exporting the doctrine of *culpa in contrahendo* into South African law.

5 2 4 2 Misappropriation of confidential information

A delictual action also lies for the misuse of confidential information disclosed in negotiations if it constitutes unlawful competition.[179] In *Southern African Institute of*

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[172] 2010 *OUCLJ* 104.

[173] A similar position is adopted in German law see Fine & Kezzler 1964 *Harv L Rev* 412.

[174] 5 2 3 2.

[175] Hutchison 2012 *SALJ* 130-131.

[176] See discussion in 5 5.

[177] See discussion in 5 2 3.

[178] 1989 *THRHR* 362-368.

[179] JM Burchell *Principles of Delict* (1993) 55.

Chartered Secretaries and Administrators v Careers-in-Sync[180] the applicant sought an interdict to prevent the respondent from misusing its confidential information. The court[181] in reaching its decision to grant an interdict considered the case of *Dun v Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau*[182] which affirmed the principles set out in the English cases of *Seagar* and *Terrapin* discussed above.[183] This action is essential to protect a party who discloses confidential information in the course of negotiations, particularly where no confidentiality agreement has been concluded. Confidential information is often disclosed out of necessity to increase the likelihood of contract conclusion and should not be exploited or unfairly used by the receiving party. In the absence of a delictual action for the misuse of confidential information there would be a substantial rise in opportunistic and malicious behaviour in the course of negotiations. Parties would be able to commence negotiations for the sole purpose of gaining access to confidential information which could then be used to compete with the party who disclosed that information in good faith, on the assumption that the parties were negotiating towards conclusion of a contract. The underlying value of good faith and public policy demand that such harm-causing behaviour be discouraged and sanctioned.

5 3 The law of unjustified enrichment

This section examines the application of the law of unjustified enrichment (or unjust enrichment, as common-law systems normally refer to it) in the pre-contractual phase, and especially the extent to which it can provide restitution where work has been done, services rendered, or goods delivered in circumstances where a contract fails to materialise. Naturally, if parties have concluded a contract allocating risk or a collateral agreement to pay for work done or services rendered, then the law of contract will apply.[184] However, parties often anticipate contract conclusion, but fail to give thought to what the consequences should be if no contract materialises.[185] The basis for

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[180] 2014 BIP 528 (GJ).

[181] Para 74.

[182] 1968 1 SA 209 (C) 213H.

[183] See ch 5 (5 2 1 4).

[184] See discussion in JE Du Plessis *The South African Law of Unjustified Enrichment* (2012) 190.

[185] McKendrick “Work Done in Anticipation of a Contract” in *Restitution* 182.

liability in these circumstances cannot be contractual.[186] It could be argued that if one party is enriched because another party, in the course of negotiations, delivered goods or performed services in anticipation of a contract that fails to materialise, the enrichment is unjust or unjustified, and should be returned.

In Germany the law of unjustified enrichment will rarely be applicable in this context because the requirements are unlikely to be met,[187] and the doctrine of *culpa in contrahendo* specifically caters for pre-contractual liability. This leaves English, American and South African law for further consideration.

5 3 1 English Law

Restitution or unjust enrichment constitutes one of the main potential sources of pre-contractual liability in English law.[188] A claim in unjust enrichment can be for the *quantum meruit* or *quantum valebant*[189] – a reasonable sum for work done or services rendered, and goods delivered respectively. The case law dealing with these claims will now be examined.

5 3 1 1 Relevant case law

In the leading case of *British Steel Corporation v Cleveland Bridge and Engineering Co Ltd*[190] ("*British Steel*") the parties entered into negotiations for the manufacturing and supply of steel nodes, which were delivered at the request of the defendant. Negotiations subsequently broke down and the claimant claimed payment for unjust enrichment while the defendant made a counter-claim for breach of contract (defective or late performance).[191] Goff J found that no contract had come into existence because there were still material terms requiring further negotiation.[192] He proceeded to state

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[186] McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 182-183; Du Plessis *Law of Unjustified Enrichment* 190-191.

[187] Dietrich 2001 *Legal Stud* 177.

[188] Giliker *Pre-Contractual Liability* 66; Beatson et al *Anson's Law of Contract* 27,45; Furmston & Tolhurst *Contract Formation* 413 - 414; Andrews *Contract Law* 23; Cartwright *Contract Law* 92; MacFarlane 2010 *OUCLJ* 112-113.

[189] J O'Sullivan & J Hilliard *The Law of Contract* 7ed (2016) 88; Furmston & Tolhurst *Contract Formation* 430.

[190] [1984] 1 All ER 504 (QBD) 504.

[191] 509-511.

[192] 510.

that if, contrary to the expectation of the parties, a contract fails to materialise then the law of unjust enrichment may impose an obligation upon the party who requested the work to pay a reasonable sum for such work.[193] British Steel was awarded a reasonable sum, (in this case the market value) for the goods delivered.[194]

A claim for unjust enrichment may also exist in respect of services rendered in the pre-contractual phase.[195] In *Cobbe v Yeoman's Row Management Ltd*[196] the parties reached an agreement in terms of which the claimant would, at his own cost, submit a planning permission application.[197] The parties agreed that if planning permission was granted the defendant would sell the property to the claimant.[198] However when planning permission was granted the defendant sought to renegotiate the terms of sale. Negotiations broke down and the claimant instituted claims on various grounds, including unjust enrichment.[199]

Scott LJ found that the services performed by the claimant increased the value of the defendant's property.[200] The defendant was unjustly enriched, at the expense of the claimant, in having received the planning permission without paying for it. The claimant was entitled to the *quantum meruit,* because he did not intend to render his services gratuitously.[201] In *Country Wide Communications Ltd v ICL Pathway*[202] the court also granted the *quantum meruit* for services rendered on the same basis but also looked at the formulation of the request to assess the extent of risk assumed by the claimant.[203]

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[193] 511.

[194] 511. The legal principles set out in the earlier decision of *William Lacey (Hounslow) Ltd v Davis* [1957] 1 WLR 932 936, 939 were also confirmed.

[195] See e.g. *Whittle Movers Ltd v Hollywood Express Ltd* [2009] EWCA Civ 1189 paras 14, 22, 19, 46; and *Countrywide Communications Ltd v ICL Pathway* [2000] CLC 324 349. The court found in the latter case that there was unjust enrichment because the defendant obtained a negative benefit by receiving services that he requested, which he otherwise would have had to pay for. Pannebakker *Letter of Intent* 134.

[196] [2008] 1 WLR 1752 para 2.

[197] Para 6.

[198] Para 6.

[199] Paras 2- 3.

[200] Para 40.

[201] Paras 40-42.

[202] [2000] CLC 324.

[203] 349.

In *Brewer Street Investments Ltd v Barclays Woollen Co Ltd*[204] the court took this type of claim for unjust enrichment a step further. In this case the parties entered into negotiations for a lease and the prospective landlord undertook to make certain renovations to the premises. Negotiations subsequently failed, and the claimants instituted a claim for expenses incurred. The court concluded that the defendants by requesting the renovations had accepted responsibility for the costs thereof even if negotiations failed.[205] The court in granting this claim conducted a fault-based enquiry – if the anticipated contract does not materialise due to the fault of the one party who for examples "simply changes his mind" or terminates negotiations for no reason at all, he should not be entitled to retain the benefit received.[206]

It is difficult to see what benefit the defendants actually received.[207] The court essentially appears to extend the law of unjust enrichment to provide a remedy where the claimant has incurred losses due to the anticipated contract failing to materialise. Various academics correctly express strong reservations regarding importing this requirement into the law of unjust enrichment.[208]

The question arises whether the legal position changes if the services performed in anticipation of a contract are merely preparatory in nature or wasted because the project is abandoned[209] and there is no provisional prior agreement as in *Cobbe* above. In *Regalian Properties Plc v London Dockland Developments*[210] the parties conducted negotiations regarding a residential development, which were eventually abandoned due to fluctuations in the property market and deadlock in negotiations.[211] The claimants instituted a claim for various expenses incurred in preparation for entry into the building lease. These expenses were incurred in obtaining expert advice, site investigations and detailed designs of the proposed development which would have enriched the defendants had they proceeded with the development. The court refused

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[204] 1954 QB 428 437.

[205] 437.

[206] 437; see also *Sambemo (Pty) Ltd v North Sydney MC* [1977[2 N.S.W.L.R 880 where this fault-based reasoning was endorsed.

[207] Giliker *Pre-Contractual Liability* 92.

[208] See discussion of Mitchell et al *Law of Unjust Enrichment* 447- 448.

[209] R Havelock "Anticipated Contracts That Do Not Materialise" (2011) 19 *RLR* 72 80.

[210] [1995] 1 WLR 212 (EWHC) 212.

[211] 212.

this claim on a number of grounds. Negotiations were expressly made "subject to contract", parties thus knew that either of them were entitled to break off negotiations without liability.[212] Unlike the *Cobbe* case, and more like the *Brewer Street* case the defendant received no benefit because the services performed were of no use to it as it decided not to proceed with the development.[213] Furthermore, the defendant had not requested the work, which was merely of a preparatory nature to place the claimant in a position to perform the contract.[214]

The following general principles may be formulated based on the case law discussed previously. Any expenses incurred in preparation for performance of the envisaged transaction fall within the ordinary business risk taken by a party conducting negotiations.[215] Compensation will not be recoverable for work done to demonstrate skills in the hope of securing a contract.[216] In *William Lacey (Hounslow) Ltd v Davis*[217] the court explained that if a builder incurs expenditure in the hope of securing a contract "he undertakes that work as a gamble and its cost is part of the overhead expense of his business, which he hopes will be met out of the profits of such contract" if his tender is successful.[218] Birks describes this as builders using "sprats to catch mackerel".[219]

Mitchell and others make an important observation – the mere fact that a party has transferred a benefit on the understanding that it will be compensated out of the proceeds of the anticipated contract does not mean that the conferring party is unconditionally accepting the risk of the contract failing to materialise "for any

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[212] 231.

[213] 231.

[214] 214, 231.

[215] Giliker *Pre-Contractual Liability* 85; C Mitchell, P Mitchell & S Watterson (eds) *Goff and Jones: The Law of Unjust Enrichment* (2016) 443-444, 529; *MSM Consulting Ltd v United Republic of Tanzania* [2009] EWHC 121 (QB) para 171(b); Regalian *Properties Plc v London Dockland Developments* [1995] 1 WLR 212 (EWHC) 212; Cartwright & Hesselink *Precontractual Liability* 119; E McKendrick *Contract Law* 12 ed (2017) 55; Cartwright *Contract Law* 93; Pannebakker *Letter of Intent* 13.

[216] Mitchell et al (eds) *Law of Unjust Enrichment* 443,530; *MSM Consulting Ltd v United Republic of Tanzania* [2009] EWHC 121 (QB) para 174.

[217] [1957] 1 WLR 932 934.

[218] 934.

[219] *Unjust Enrichment* (2005) 144.

reason".[220] They do not go so far as to suggest that a fault-based inquiry should be applied to determine whether benefits conferred, in the course of failed negotiations, should be returned.

If both parties are conducting negotiations on the basis that each is responsible for their own risks in the course of negotiations then the law should not intervene.[221] *Cobbe* was exceptional because in that case the parties had agreed that the defendant would carry out the work and the contract failed to materialise as a sole result of the defendant's unilateral decision to demand a higher price and withdraw from negotiations[222] after receiving the benefit of the defendant's work.

5 3 1 4 Evaluation of the law of unjust enrichment as a source of liability

The requirements for an enrichment claim traditionally are that the defendant must have received a benefit, to the detriment of the claimant, and it must be unjust to allow the defendant to retain the benefit.[223] The conceptual basis of these claims has been unclear and inconsistent particularly in the context of work done or services rendered.[224] These conceptual difficulties are significant,[225] but a comprehensive analysis of the complexities and accompanying academic debates fall beyond the scope of this thesis. For our purposes, the focus remains on whether there are circumstances where the English law of unjust enrichment or restitution should be applied to impose an obligation to return benefits received by a party during failed negotiations.

English law clearly recognises specific cases where benefits transferred in anticipation of a contract which does not materialise should be returned by the receiving party. These cases reflect a carefully crafted balance between the "preliminary risk taking phase" and the next phase; where the benefit conferred is

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[220] Mitchell et al (eds) *Law of Unjust Enrichment* 445.

[221] Giliker *Pre-Contractual Liability* 85-86; Chen-Wishart "The Agreement" in *Chitty on Contracts* 335; Mitchell et al (eds) *Law of Unjust Enrichment* 531; McKendrick *Contract Law* 55. See e.g. *Regalian Properties Plc v London Dockland Developments* [1995] 1 WLR 212 (EWHC) 212 and *MSM Consulting Ltd v United Republic of Tanzania* [2009] EWHC 121 (QB).

[222] Mitchell et al *Law of Unjust Enrichment* 446.

[223] Furmston & Tolhurst *Contract Formation* 414; O' Sullivan & Hilliard *Law of Contract* 87; Birks *Unjust Enrichment* 39; Pannebakker *Letter of Intent* 128.

[224] Mitchell et al (eds) *Law of Unjust Enrichment* 441-442.

[225] Giliker *Pre-Contractual Liability* 88.

clearly not intended to be gratuitous and goes beyond costs incurred in the hope of a contract materialising.[226]

However cases like *Brewer Street Investments* are problematic because the court attempts to give the claimant a remedy he otherwise would not have had, by classifying his losses as a benefit conferred upon the defendant.[227] This suggests that a "fictitious benefit"[228] is sufficient to found a claim for unjust enrichment. Some courts have also made awards measured by the aggrieved party's wasted expenditure.[229] Enrichment claims cannot cater for all pre-contractual losses and the availability of remedies arising from other sources of law should be investigated before making illogical developments to the law of unjust enrichment.[230]

5 3 2 American law

American law also recognises claims for restitution of benefits conferred in the pre-contractual phase.[231] Farnsworth describes this as a "compelling ground for precontractual liability."[232] The application of the laws of restitution or unjust enrichment is however limited by the aleatory view of negotiations[233] and the high

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[226] Birks *Unjust Enrichment* 144; see e.g. *Cobbe v Yeoman's Row Management Ltd* [2006] WLR 2964; *British Steel Corpn v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504 (QBD) 504.

[227] *Countrywide Communications Ltd v ICL Pathway*s [2000] CLC 324 (QBD) 349; Mitchell et al (eds) *Law of Unjust Enrichment* 528; O Sullivan & Hilliard *Law of Contract* 90; see also Giliker *Pre-Contractual Liability* 96; McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 180; S Hedley "Work Done in Anticipation of a Contract Which Does Not Materialise: A Response" in *Restitution* 195; Pannebakker *Letter of Intent* 129.

[228] See *Countrywide Communications Ltd v ICL Pathway* [2000] CLC 324 349; see also McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 178. Furmston & Tolhurst *Contract Formation* 414.

[229] Mitchell et al (eds) *Law of Unjust Enrichment* 528; see *Countrywide Communications Ltd v ICL Pathways* [2000] CLC 324 and the judgment of Denning LJ in *Brewer Street Investments Ltd v Barclays Woollen Co Ltd* (1954) 1 QB 428 paras 16-19.

[230] Mitchell et al (eds) *Law of Unjust Enrichment* 536-537, 538; McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 177, 178, 180; Giliker *Pre-Contractual Liability* 95-96,102-103.

[231] Pannebakker *Letter of Intent* 180; Farnsworth 1987 *Colum LR* 229; Turack 1990 *Am J Comp L* 128; Scott 2007 *Ohio ST LJ* 92; Farnsworth *Contracts* 192; L Bebchuck & O Ben-Shahar "Precontractual Reliance" (2001) 30 *Legal Stud* 423 424.

[232] Farnsworth *Contracts* 192.

[233] Farnsworth *Contracts* 189-190; Pannebakker *Letter of Intent* 181.

threshold set to succeed with such a claim.[234] It is generally accepted that a party incurs pre-contractual expenditure for his own benefit and not usually for the benefit of the other party;[235] courts accordingly regard any benefits conferred or losses suffered as a justified risk of negotiations.[236] For example, expenses incurred by a sub-contractor, assisting the contractor to secure a bid, are usually regarded as "the costs of doing business".[237] In *Songbird Jet Ltd v Amax*[238] the court explained that the time and expenses incurred in the course of negotiations are the "common grist of negotiations aimed towards consummation of an agreement… the endeavours by either side, if they fail, do not warrant a claim that one party has been unjustly enriched at the expense of the other."[239]

Nevertheless claims for restitution or claims based on unjust enrichment may arise in the pre-contractual phase. Firstly, a claim may exist where one party has benefited from the use of a novel idea or information disclosed in the course of negotiations;[240] secondly, a claim may exist where a party has rendered services, during unsuccessful negotiations, and in anticipation of a contract that does not materialise.[241] Few cases have entertained these types of enrichment claims.[242] The limited case law will now be critically evaluated.

In *Hill v Waxberg,*[243] the respondent claimed the reasonable value of services rendered and expenses incurred in anticipation of a building contract. The court concluded that Waxberg's services, which included consultations with architects, surveying the property, and being instrumental in collecting the necessary data to obtain financing from the Federal Housing authority, were "virtually irreplaceable" and could not have been substituted without "considerable additional expense" to the

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[234] Farnsworth *Contracts* 180.

[235] Pannebakker *Letter of Intent* 181; Farnsworth 1987 *Colum LR* 231.

[236] Irakli 2017 *ESJ* 68; Farnsworth *Contracts* 193.

[237] Turack 1990 *Am J Comp L* 130.

[238] 1984 581 F Supp 912 (S D N Y) 926.

[239] 926.

[240] See e.g. *Massachusetts Eye and Ear infirmary v QLT Phototherapeutics* (2009) 552 F 3d 47 (CA) 51-53; J Gordley *Foundations of Private Law: Property, Tort, Contract, Unjust Enrichment* (2006)

[241] Pannebakker *Letter of Intent* 183; Turack 1990 *Am J Comp L* 128,130; Farnsworth *Contracts* 192-193.

[242] Farnsworth 1987 *Colum LR* 232.

[243] (1956) 237 F 2d 936 (9th Cir) 937.

defendant.[244] It is significant that the court concluded that "it makes no difference whether the pay expected [by the performing party] is in the form of an immediate cash payment, or in the form of profits to be derived from a contract, the consummation of which would or should be anticipated by reasonable men…"[245]

In *Longo v Shore & Reicht Ltd*[246] the court found that the claimant, a prospective employee, was entitled to the *quantum meruit* for services rendered and equipment provided, even though the employment contract was not executed because the defendant had accepted those services and there was an expectation of compensation.[247]

In *Earhart v William Low Co*[248] the court explained that a claim for restitution will lie, and a benefit will be conferred, if the claimant does work at the request of the defendant.[249] However, Farnsworth highly doubted that this definition of benefit would receive widespread support in case law.[250] His doubts were well-founded – there are few subsequent cases entertaining claims for benefits conferred in anticipation of contract that does not materialise.[251] The reason for this appears to be that pre-contractual expenses for services rendered or work done, "typically result in no benefit being conferred on the other party".[252] Aggrieved parties are thus disinclined to bring these types of claims.

Unjust enrichment is an inapposite source of pre-contractual liability if a party seeks to claim for pre-contractual losses in circumstances where no benefit in the true sense of the word has been conferred upon the parties. This sentiment is supported by the limited case law. That being said, the *Waxberg* case illustrates that if a true benefit has been conferred upon a party, American courts are willing to found a claim in unjust enrichment. A party will be entitled to restitution for the value of the services rendered,

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[244] 938, 939.

[245] 938-939.

[246] (1984) 25F 3d 94 (2d Cir) 97.

[247] 98.

[248] (1979) 25 Cal 3d 503.

[249] 510-512.

[250] Farnsworth 1987 *Colum LR* 223.

[251] Farnsworth *Contracts* 192.

[252] Farnsworth *Contracts* 192; Farnsworth 1987 *Colum LR* 233; Turack 1990 *Am J Comp L* 130; see e.g. *Reprosystem v SCM Corp* 1984 727 F 2d 257 (2d Cir).

if "something in the nature of an implied contract results" where one renders services at the request of another, and in the process confers a benefit on the other.[253]

5 3 3 South African law

It is not uncommon for parties to perform work, render services, or transfer assets as a form of advance "performance" in anticipation of a contract being concluded.[254] The question is whether an enrichment claim arises if such an advance "performance" takes place in the course of failed negotiations. South Africa does not currently recognise a general enrichment action.[255] An enrichment claim must fit into one of the specific enrichment actions, or a claimant must argue for recognition of an action in new circumstances.[256] The two forms of enrichment potentially applicable in this context are the enrichment actions for the transfer of property and for services rendered or work done. However, the distinction between property and services should not be overstated or distract from the main focus of our analysis, which is whether some value was given in anticipation of a contract being concluded.

This analysis will engage with difficult questions regarding the proper allocation of risk in the pre-contractual phase, and whether as a matter of policy, a party should be able to claim back expenses or require the defendant to give up enrichment pursuant to unsuccessful negotiations.

5 3 3 1 Property transferred

If a party transfers money or property in the course of negotiations and it is clear that such party did so as a form of accelerated performance of the envisaged contract that is eventually not concluded, a claim may potentially lie for unjustified enrichment on the basis of the *condictio causa data causa non secuta*.[257] This action is available where the claimant transferred something to another, not to fulfil an existing obligation, but in the expectation of a future outcome, which does not materialise.[258] In *Wepener*

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[253] *Hill v Waxberg* (1956) 237 F 2d 936 (9th Cir) 937.

[254] Hutchison 2012 *SALJ* 107; Du Plessis *Law of Unjustified Enrichment* 36, 119.

[255] JG Lotz & FDJ Brand "Enrichment" in WA Jourbert (ed) *LAWSA* 9 *2* ed (2005) para 208; Du Plessis *Law of Unjustified Enrichment* 4.

[256] *Nortje v Pool* 1966 3 SA 96 (A) 139-140; Lotz & Brand "Enrichment" in *LAWSA* para 208; Hutchison 2012 *SALJ* 106; Du Plessis *Law of Unjustified Enrichment* 2.

[257] Du Plessis *Law of Unjustified Enrichment* 191; Hutchison 2012 *SALJ* 107.

[258] D Visser *Unjustified Enrichment* (2008) 455; Hutchison 2012 *SALJ* 108; JC Sonnekus *Unjustified*

v Schraader[259] for example, the claimant transferred possession of the premises to the defendant during sale negotiations, and the defendant paid part of the purchase price in advance. This payment was made in the expectation of a shared understanding that an agreement of sale would be concluded, but this never happened.[260] This case indicates how the *condictio causa data causa non secuta* could apply where mutual understanding regarding the purpose of a transfer (the advance payment) was not realised.

5 3 3 2 Services rendered

The claim for services rendered in the pre-contractual phase is more problematic because it raises greater concerns regarding the proper allocation of pre-contractual risk than returnable property dealt with above. Claims must be cautiously scrutinised to avoid disrupting this allocation.[261] Difficulties also arise because services rendered do not confer tangible or corporeal property upon the receiving party. Therefore the receiving party cannot return a tangible, easily identifiable enrichment. Whether there has been unjustified enrichment would need to be established with reference to the value derived by the defendant of the services rendered.

We observed that English courts grant enrichment claims for services rendered during failed negotiations, particularly where it gives rise to an identifiable end-product or saves the defendant a necessary expense.[262] Similarly in South African law, a receiving party's estate may be enriched if there is an end-product of a distinct value, or the receiving party saves a necessary expense.[263] In these circumstances a party may be entitled, under a South African enrichment action, to the reasonable costs of performing such service.[264] However, conferring a benefit on the defendant in the course of negotiations is not in itself sufficient to justify a claim. We need to determine an appropriate action and the basis upon which the party did the work or rendered the

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Enrichment in South African Law 2 ed (2017) 168, where the author provides a detailed formulation of this action.

[259] 1903 TS 629.

[260] Du Plessis *Law of Unjustified Enrichment* 191 fn 76.

[261] Hutchison 2012 *SALJ* 108.

[262] See ch 5 (5 3 1).

[263] Du Plessis *The Law of Unjustified Enrichment* 36-37.

[264] 37.

service is crucial to establishing whether the enrichment is without legal ground and should be returned pursuant to such an action. For example, the performance may have taken place under a contract that turns out to be void or is subsequently cancelled due to imperfect performance.[265]

Here we are dealing with distinct and more problematic cases where a party does work or renders services in anticipation of a contract that does not materialise. Often parties do so in the hope of securing a contract[266] or on the basis that costs will be recovered out of the profits of the contract. Hutchison confirms that these cases are excluded from the action for services rendered or work done;[267] that action traditionally applies in cases where the purpose of the transfer is fulfilment of a valid obligation, which then failed due to circumstances such as breach.[268] The question arises whether another enrichment action can be raised in this context. We shall first consider the potential application of the *condictio causa data causa non secuta.* If there is a mutual understanding that services are rendered as a form of accelerated performance and the contract is eventually not concluded, it is not apparent, as a matter of principle, why a claim should not lie for unjustified enrichment on the basis of the aforementioned action, merely because the benefit did not assume the form of a transfer of money or property .

In evaluating the possibility of this development, it may be useful to consider case law dealing with enrichment claims for additional work performed beyond the contractually agreed upon scope of work. In *Skyword (Pvt) Ltd v Peter Scales (Pvt) Ltd*[269] the dispute related to additional repair work carried out by the claimant without the knowledge or consent of the defendant. The court found that although Roman-Dutch law does not yet recognise a general enrichment action, the claimant nevertheless has a claim founded on the law of unjustified enrichment.[270] The defendant accepted such liability, but unfortunately did not indicate under which specific action it may have been liable, thus absolving the court from having to make

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[265] D Visser *Unjustified Enrichment* (2008) 552.

[266] Hutchison 2012 *SALJ* 108.

[267] 108-109.

[268] Visser *Unjustified Enrichment* 552.

[269] 1979 1 SA 570 (R) 572-573.

[270] 573.

such a determination. The court gave an award for the claimant's additional work to the extent it enriched the defendant.[271]

In *MM Moloto Properties (Pty) Ltd v Municipality of Lephalale*[272] the claimant claimed the costs for additional work to complete a storeroom and ablution facilities. The parties raised two alternative arguments, but our focus will be on the second, namely that the defendant had been enriched at the expense of the claimant.[273] The quantum and the fact that the enrichment was without legal ground was common cause.[274] There was no doubt that the defendant had been enriched by the completed facilities. Furthermore, the claimant was impoverished "in that it provided services and materials without payment."[275] The claimants claimed the agreed upon quantum on the basis of the *condictio indebiti.* This assumes that it was mistaken as to liability under the existing contract. However, inasmuch as additional work was not done in purported fulfilment of an existing obligation, but rather in the expectation of an obligation to pay arising in future, this *condictio* would not have been applicable.[276]

Both of the above mentioned cases illustrate the possibility that one of the *condictiones* and more specifically a *condictio causa data causa non secuta,* can in appropriate circumstances be extended to form the basis of a claim for unjustified enrichment for work done or services rendered in anticipation of a contract that does not materialise.[277] As far as other possible claims are concerned, Hutchison has argued that an action based on managing another's affairs (*negotiorum gestio*) would be inapposite.[278] The *actio negotiorum gestio* should indeed only be available in circumstances where services are rendered or work is done without any knowledge of the defendant and which, from the claimant's perspective, is in the interests of the defendant.[279] *Negotiorum gestio* is therefore inappropriate in the present context,

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[271] 575.

[272] 2015 JDR 1731 (GP).

[273] Para 1.

[274] Para 4.

[275] Para 4-5.

[276] Para 5.

[277] See discussion in Sonnekus *Unjustified Enrichment* 133-134.

[278] 2012 *SALJ* 109.

[279] See Sonnekus *Unjustified Enrichment* 281-285 for the requirements to succeed with a claim based on the *actio negotiorum gestio*.

because neither of these circumstances may be present.

Ultimately, however, the exact label or name attached to an enrichment claim may be less important than identifying the general principles that could apply when seeking restitution for transfers made in the failed expectation of future contracts.[280] Whether the transfer is of property or takes the forms of services should not matter.[281] In both cases the defendant accepts a benefit on the basis of some form of mutual or tacit understanding that it is a form of accelerated performance of the anticipated contract. In the absence of such a basis, conferring the benefit forms part of risks assumed by a party in the course of contractual negotiations in the hope of securing a contract, and the defendant's enrichment would not be without legal ground. [282] Although a claim for services rendered in the pre-contractual phase does not easily fit into any of the existing actions, Glover[283] and Scott[284] both note that these actions have been developed to serve modern commercial needs.[285] It is thus argued that if the appropriate case regarding work done or services rendered in anticipation of a contract was brought before the court, it may be willing to develop the existing actions to provide relief to a deserving claimant.

5 4 International instruments

Thus far we have discussed pre-contractual liability at a national level in specific civil-law and common-law countries. Our focus will now be broadened to pre-contractual liability arising from supra-national rules or international instruments. While these international instruments are merely model rules and not legally binding conventions,[286] they could potentially aid the development of national rules.

The nature and source of the pre-contractual liability flowing from these instruments are uncertain and controversial because it could be regarded as contractual or

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[280] See *McCarthy Retail Ltd v Shortdistance Carriers CC* 2001 (3) SA 482 (SCA) para 10.

[281] *Unjustified Enrichment* 266.

[282] See discussions of Birk's example in 5 3 1.

[283] "Reflections on the Sine Causa Requirement and the Condictiones in South African Law" (2009) 3 *Stell LR* 468-469.

[284] *Unjustified Enrichment in South African Law: Rethinking Investment by Transfer* (2013) 468-469.

[285] 468-469.

[286] Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 361.

delictual; for present purposes it is accepted that it does not fall properly into either of these sources, but is a form of sui generis liability.[287] This sui generis liability allows flexible rules to be established that need not accord with the principles of contract or delict.[288] The relevant sections of the UNIDROIT Principles of International Commercial Contracts ("PICC)"and Principles of European Contract Law ("PECL") regulating the pre-contractual phase will now be critically evaluated.

Article 2.1.15 of the PICC provide 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; and
> (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."

Article 2:301 of the PECL contains a very similar provision, save that the wording provides that a party who breaks off negotiations "contrary to good faith" is liable for losses caused to the other party. Some commentators suggest that the reference to "bad faith" in article 2.1.15 of the PICC restricts the scope of liability. However, this contention has been rejected on the basis that "bad faith" conduct is synonymous with conduct "contrary to good faith and fair dealing".[289]

Both the PECL[290] and the PICC share the point of departure that parties are free to break off negotiations.[291] They nevertheless qualify this freedom by providing for liability for breaking off negotiations in bad faith or contrary to good faith.[292] The PICC contain three illustrations of bad faith in negotiations.[293] Firstly, entering into or continuing lengthy negotiations without intending to conclude the anticipated contract; secondly, failing to reveal knowledge of an impediment to contract conclusion during

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[287] Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 370; Beale et al *Cases, Materials and Text* 337.

[288] Beale et al *Cases, Materials and Text* 337.

[289] Rios "Art. 2.1.15 - 2.1.16 Negotiations" in S Vogenauer (ed) *Commentary on the PICC* 345 352-353; Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 362.

[290] See article 2:301(3).

[291] Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 360.

[292] 360.

[293] See article 2.1.15 read with comment 2 thereto and illustrations 1-3.

negotiations, such as receiving a necessary license; lastly, entering into negotiations without the necessary authority.

Babusiaux describes the first scenario above as an abuse of contractual freedom.[294] The difficulty with imposing liability for this conduct lies in proving that the party misrepresented his intention to conclude the contract.[295] However, it is suggested that article 2:102 of the PECL can assist with this determination.[296] This provision reads as follows: "the intention of a party to be legally bound by contract is to be determined from the party's statements or conduct as they were reasonably understood by the other party." This process requires courts firstly to consider whether the conduct of the other party outwardly manifests an intention to conclude the contract and secondly whether such conduct would reasonably be perceived by third parties as a misrepresentation of the intention to conclude a contract.[297]

According to the PICC, negotiations may reach a stage where they cannot be broken off "abruptly and without justification".[298] The circumstances of the particular case will ultimately determine whether this stage has been reached. Whether the conduct of the party during negotiations has reasonably induced the other party's reliance that a contract would be concluded, and the consensus reached on outstanding terms, are of particular relevance.[299] In her discussion of the PECL, Babusiaux suggests that the aggrieved party must legitimately believe that the other party intended to conclude a contract and the other party, to avoid liability, will need to show the existence of a legitimate reason for breaking off negotiations.[300] Both the PICC[301] and PECL[302] limit an aggrieved party's claim for breach of the obligations set out above to reliance damages, including all expenses incurred in the course of

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[294] Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 360, 367.

[295] 368.

[296] 368.

[297] 368.

[298] See Article 2.1.15 read with comment 4 thereto.

[299] See Article 2.1.15 read with comment 4 thereto; see also illustration 5.

[300] Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 369.

[301] Art 2.1.15 read with comment 2.

[302] Art 2:301(2)

negotiations and forgone opportunities.

Rios argues that the provisions and illustrations of the PICC can inform the development of other international instruments and national rules on pre-contractual liability.[303] The same sentiment is extended to the PECL here. The question then arises as to how the imposed obligation of good faith should be interpreted. It must be emphasised that these instruments entrench freedom of contract, therefore the qualification of good faith must be interpreted as a corrective mechanism that limits such freedom of contract.[304] Good faith can be understood as an "objective standard of conduct" and requires, in the context of negotiations, that parties conduct themselves in a reasonable and consistent way.[305]

These instruments and the related academic commentary could provide valuable insights and guidance for the development of South African law on pre-contractual liability. The proposed developments to the South African law of delict as a source of pre-contractual liability outlined above aligns with pre-contractual liability arising from international instruments. This is particularly illustrated in the proposed formulation of the wrongfulness test for liability in respect of negligent misrepresentations. To add to this, it is proposed that the wrongfulness test encapsulates the "good faith" standard and two-step test set out in the commentary and interpretation of the international instruments above. The principles derived from these instruments can be utilised to carefully extend delictual liability to negligent misrepresentations regarding the conclusion of a contract, while maintaining a threshold that protects freedom to break off negotiations without incurring liability. Furthermore, any liability for misrepresentation will be aimed at placing the party in the position he would have been in had the misrepresentation not been made and would therefore not include any gains that would have been made had the contract been concluded as this would be too speculative in nature.

5 5 Conclusion

Common-law systems are generally less inclined than civil systems to intervene in the

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[303] "Art. 2.1.15 - 2.1.16 Negotiations" in *Commentaries on the PICC* 348-349.

[304] Babusiaux "Art 2:301: Breach of Confidentiality" in Jansen & Zimmermann (eds) *Commentaries on European Contract Laws* 367.

[305] 367.

pre-contractual phase to allow recovery of pre-contractual losses suffered due to termination of negotiations. It is unlikely that a set of rules similar to *culpa in contrahendo* will be accepted into these systems.[306] Nevertheless, common-law systems are becoming more receptive to imposing pre-contractual liability. Due to the deficiencies in their respective law of torts, English and American law have relied predominantly on the law of unjust enrichment and estoppel to provide recovery for losses incurred during the pre-contractual phase.

Although this comparative analysis provides valuable insights into the imposition of pre-contractual liability, South African law ultimately needs to be developed in a manner that fits its own purposes. For example, South Africa does not face the same limitations that characterise the English, German and American law of tort or delict, because it is more receptive to claims for negligently-caused pure economic loss.

There are clear grounds for the development of the South African law of delict as a source of pre-contractual liability.[307] This would indirectly give effect to the obligation to negotiate in good faith, at least insofar as it recognises liability for negligent misrepresentations in the course of unsuccessful negotiations. Courts have already recognised that fraudulent or negligent misrepresentations inducing a contract give rise to delictual liability. It would therefore not be unimaginable to extend liability to recognise claims for misrepresentations that fraudulently or negligently induce the reliance that a contract will be concluded. The wrongfulness enquiry, as informed by the principles derived from the comparative analysis above, can be applied to limit the scope of claims and avoid opening of the floodgates of litigation.

The focus on the law of delict as a promising source of liability does not exclude the potential operation of the law of unjustified enrichment in the pre-contractual phase.[308] It has been observed that in both South Africa and foreign jurisdictions, liability on the basis of unjustified enrichment for property transferred or work done and services rendered during the pre-contractual phase can be problematic. Despite the seemingly low prospects of this type of claim, it is argued here that given the right circumstances,

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[306] See Klass *Contract Law* 98-99, Van Huyssteen & Maxwell *Contract Law* paras 191-194; McKendrick "Work Done in Anticipation of a Contract" in *Restitution* 186,187.

[307] C Lewis "The Uneven Journey to Uncertainty in Contract" (2013) 76 *THRHR* 80 89; Hutchison 2012 *SALJ* 129-131.

[308] Hutchison 2012 *SALJ* 131.

enrichment actions could be applied or extended to allow this type of claim.

Proposing developments to non-contractual sources of law in South Africa, as discussed above, does not exclude the possibility of developments to the law of contract nor does it negate the need for such developments. We observed that by making incremental developments to the South African law of delict and the law of unjustified enrichment it is possible to create an ex lege duty not to break off negotiations in bad faith and in doing so indirectly give effect to the underlying value of good faith. Assuming that these developments do take place, it would be anomalous to recognise and enforce a legal or automatic duty to negotiate in good faith, but fail to enforce a contractual obligation to negotiate in good faith that has been voluntarily entered into with the requisite *animus contrahendi*. Some would argue that developments to non-contractual sources of law negates the need for developments to the law of contract which will be far-reaching and could potentially water down the validity requirements for a contract and undermine legal certainty. However, this contention must be rejected. Our analysis in chapter 3 and here clearly illustrates that there are grounds for development in both the law of contract and non-contractual sources of law, and the development of one source of law will necessarily require development of the other.

Chapter 6: Conclusion

6 1 The key issues raised by pre-contractual agreements

The demands of modern commerce are changing the manner in which business professionals conduct their business, and more specifically how they choose to regulate commercial negotiations and contract conclusion. We have seen a drastic rise in the use of a diverse range of pre-contractual instruments, which are intended to perform different functions including, but not limited to, the simplification of the negotiation process and the facilitation of contract conclusion. However, as indicated above, great uncertainty exists regarding the exact legal nature and consequences of these instruments. It has become clear that drawing definitive conclusions regarding the contractual validity and legal consequences of pre-contractual agreements is crucial to ensuring that their utility is not undermined and that they do not give rise to unintended legal consequences.

It is acknowledged that pre-contractual agreements are inherently difficult to regulate, as they do not have any standardised legal content. Although different pre-contractual agreements can display common features, their wording and content can vary greatly. This thesis sought to clarify the South African legal position on pre-contractual agreements by classifying the different types of pre-contractual agreements in accordance with the function they perform. Once this was done, it was easier to identify and evaluate what legal consequences, if any, arise or should arise from these different agreements. However, it must be emphasised that no hard and fast rules determine these consequences.

6 1 1 Functions of pre-contractual agreements

As previously discussed,[1] pre-contractual agreements can perform many different functions. A preliminary observation that constituted an important point of departure into our analysis of the legal character of pre-contractual agreements is that a pre-contractual agreement need not necessarily give rise to legal consequences to perform a valuable function in commerce.

We observed that a number of vital functions are served by non-binding pre-

[1] See ch 2.

contractual agreements.[2] These agreements often merely record the consensus reached thus far between parties and establish the terms upon which they are willing to proceed with a transaction. In this way pre-contractual agreements can serve as a "road-map" towards the conclusion of a final contract.[3] Non-binding pre-contractual agreements are often also a prerequisite for obtaining third party approval (for example obtaining approval for a loan necessary to finance the envisaged transaction). Notwithstanding their non-binding nature, pre-contractual agreements can convey a commitment to negotiations, build trust in the course of negotiations and even impose moral obligations on the parties to comply with their commitments. In fact, we observed that these moral obligations often prove to be a more persuasive force in encouraging or coercing parties to comply with their obligations than the threat of legal consequences flowing from a contract.[4]

If non-binding pre-contractual agreements are so useful, the question naturally arises whether these types of agreements should ever be legally binding; can circumstances arise where it is necessary to attach legal consequences to them? Can pre-contractual agreements perform useful legal functions or are we, by attempting to attribute a legal character to them, risking their utility and attaching unintended legal consequences that will give rise to a whole host of difficulties for the parties involved? The far-reaching implications of adopting a view in favour of the legal validity of specific pre-contractual agreements strongly influenced the process of answering these difficult questions.

Various legal obligations can potentially arise from pre-contractual agreements. In this regard we can distinguish between intermediate legal obligations regarding the negotiation process itself and legal obligations in respect of the principal contract. Intermediate legal obligations refer to legal obligations such as confidentiality and exclusivity in the course of negotiations. A pre-contractual agreement could also potentially constitute the principal contract or give rise to a binding obligation to conclude such principal contract. Falling in the grey area, is the obligation to negotiate in good faith, which can either impose an obligation regarding the process of negotiations or impose a more significant obligation regarding the conclusion of the

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[2] 2 2 and 2 3 1 4.

[3] 2 2 and 2 3 14.

[4] See ch 2.

principal contract itself.[5]

6 1 2 Conceptual difficulties raised by pre-contractual agreements in South Africa

In South Africa, pre-contractual agreements are only enforced to an extremely limited extent because a clear distinction is drawn between the pre-contractual phase, which traditionally does not give rise to legal liability, and the contractual phase, which does.[6] This legal position reflects the great importance attached to the interrelated concepts of freedom of contract and freedom of negotiation, on the one hand, and the requirements for a valid contract to come into existence, on the other. Before one can speak of a pre-contractual agreement giving rise to contractual obligations, it must meet the requirements for a valid contract. Two validity requirements that are particularly relevant when analysing a pre-contractual agreement are certainty, and having the *animus contrahendi* (the intention to be bound).

Often pre-contractual agreements are drafted by business professionals in a simplistic and incomplete form and it can be difficult to ascertain definitively whether these requirements are met. In this thesis we considered how conceptual difficulties could be addressed and overcome so as to determine which types of pre-contractual agreements can give rise to contractual obligations (if any) and what the nature of those obligations will be. In this regard, we specifically considered the enforceability of agreements to negotiate as a specific type of pre-contractual agreement.

6 2 Comparative observations

Before turning to the position in South African law, we considered the legal position in relation to pre-contractual agreements in common-law and civil-law legal systems to determine whether such an investigation yielded any insights that might assist in an analysis of the South African legal position and its potential development.

As a point of departure, we saw that common-law systems in general have been much more conservative and cautious in their regulation of pre-contractual liability, and more specifically in their treatment of pre-contractual agreements.[7] English law, for example, has remained steadfast in its non-recognition of pre-contractual agreements, which

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[5] See ch 2 and 3.

[6] See ch 3.

[7] 3 2 2 1(ii) - (iii).

aligns with the traditional position in South African law.[8]

Although English courts have thus far refused to attribute any legal consequences to pre-contractual agreements, various English academics have called for this legal position to be reassessed. Trakman and Sharma, for example, argue that agreements to negotiate in good faith should not lightly be dismissed as unenforceable due to a lack of certainty or being contrary to public policy.[9] There are significant commercial justifications supporting the enforcement of agreements to negotiate in good faith. Parties to commercial negotiations may rely on these agreements and consequently forgo offers from third parties or incur substantial costs in the course of negotiations.[10] If English courts are willing to enforce negotiation obligations forming part of pre-existing contracts, then there is little reason, in principle, for courts to arbitrarily conclude that independent agreements to negotiate are without legal content.[11] It may be more difficult in the absence of other contractual obligations to ascertain the parties' intention to be bound, but it is not impossible to do so.[12]

American law, in contrast, has experienced substantial development in relation to the enforceability and legal consequences of pre-contractual agreements. This jurisdiction provided useful insights into potential areas of development and identified key risks or difficulties that may arise in choosing to develop the law relating to pre-contractual agreements.[13] Although the approach to pre-contractual agreements differs between different American states, several states have chosen to enforce specific types of pre-contractual agreements. In the seminal American case of *Teachers Insurance & Annuity Association of America v Tribune Co*[14] ("*Tribune Co*"), the court recognised two types of enforceable preliminary agreements. Type I preliminary agreements are complete agreements, but parties merely desire to

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[8] 3 2 2 1(ii).

[9] "The Binding Force of Agreements to Negotiate in Good Faith" (2014) 73 *CLJ* 598 599.

[10] 599.

[11] Trakman & Sharma 2014 *CLJ* 598 621; J Chen "Should English Contract Law Adopt a General Duty to Negotiate in Good Faith" (2017) 4 *BLR* 21, who also argues that independent agreements to negotiate should be enforceable if sufficiently certain; see also the discussion in ch 3 (3 2 2 1 (i)).

[12] Trakman & Sharma 2014 *CLJ* 621.

[13] See ch 3 (3 2 2 1 (ii)).

[14] (1987) 670 F Supp 491 (S D N Y) 494; see ch 3 (3 2 2 1 (ii) (a)).

memorialise the agreement in a particular form.[15] Type II preliminary agreements outline the major terms of the transaction but leave terms open that remain to be negotiated.[16] Judge Leval explained that parties to the latter agreement "can bind themselves to a seemingly incomplete agreement in the sense that they accept a mutual commitment to negotiate in good faith in an effort to reach final agreement within the scope that has been settled in the preliminary agreement."[17]

Burton and Andersen, writing in the context of American law, explain that various contractual duties can be imposed by agreements to negotiate.[18] Such agreements can impose "procedural duties" or a specific standard of behaviour in the course of negotiations.[19] They can also commit parties to certain terms exclusively for purposes of negotiation (meaning that the terms are non-binding) or bind parties to the final contract, irrespective of the outcome of negotiations.[20]

It became clear from the analysis of American law that pre-contractual agreements can indeed give rise to useful legal obligations that perform a valuable function in commerce. For example, we observed that agreements such as memoranda of understanding, letters of intent and term sheets are concluded at a time when parties have progressed in contractual negotiations and reached a stage that requires one or both of them to make substantial relationship-specific investments and potentially forgo other commercial opportunities without assurance regarding the materialisation of the final contract.[21] It appears that American courts have moved towards the recognition of an intermediate stage of contracting. "Embedding" an intermediate contractual obligation to negotiate in good faith gives a contracting party the assurance that his pre-contractual investments are protected in the sense that the other party is no longer free to break off negotiations in bad faith at any time and for any reason without liability.[22] American law also offered various suggestions regarding the issue

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[15] (1987) 670 F Supp 491 (S D N Y) 494; ch 3 (3 2 2 1 (ii) (a)).

[16] 499.

[17] 498.

[18] *Contractual Good Faith: Formation, Performance, Breach, Enforcement* (1995) 334.

[19] 334.

[20] 334; see ch 3 (3 2 2 1 (ii)).

[21] See ch 3 (3 2 2 1 (ii) (a)); JM Creed "Integrating Preliminary Agreements into the Interference Torts" (2010) 110 *Colum LR* 1253 1254,1272-1274.

[22] 1273.

of appropriate remedies for the breach of various pre-contractual obligations and seemed to settle on a claim for reliance damages for breach of an obligation to negotiate.[23]

Determining the enforceability of pre-contractual agreements in civil-law systems does not pose the same prominent conceptual challenges as in the common-law jurisdictions. We observed in particular that civil-law systems such as Germany recognise that the commencement of negotiations give rise to an ex lege or automatic pre-contractual duty to negotiate in good faith, and this obligation is only strengthened by the existence of a pre-contractual agreement.[24] A negotiating party will have a claim on the basis of the doctrine of *culpa in contrahendo* for reliance losses suffered as a result of the other party breaking off negotiations in circumstances where the reasonable impression was created that the contract would in all likelihood be concluded.

American law and German law illustrate two different, but not necessarily mutually exclusive, courses of development. American law on the one hand chose to develop its contract law to recognize agreements imposing intermediate obligations (i.e. the obligation to negotiate in good faith), but not binding parties to conclude the final contract. German law on the other hand implemented the general doctrine of *culpa in contrahendo* that renders the conceptual debates around the enforceability of agreements to negotiate, for the most part, moot.

6 3 The enforceability of different types of agreements to negotiate in South Africa

In setting out the legal position in relation to agreements to negotiate in South African law, we must draw a distinction agreements to negotiate in good faith that do contain deadlock-breaking mechanisms and those that do not. The type of agreement to negotiate will determine both the enforceability and the legal consequences (if any) of the agreement. With this in mind, we shall turn to consider the enforceability of agreements to negotiate in good faith.

6 3 1 Agreements to negotiate that contain deadlock-breaking mechanisms

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[23] See ch 4 (4 2 2).

[24] See ch 3 (3 2 2 1 (ii)).

In the seminal case of *Southernport Development (Pty) Ltd v Transnet Ltd*[25] *("Southernport")* the court recognised that agreements to negotiate in good faith that are intended to be binding and therefore contain a deadlock-breaking mechanism are enforceable. The court emphasised the importance of the obligation to negotiate in good faith being accompanied by a deadlock-breaking mechanism to prescribe what steps should be taken in the event that parties are unable to reach agreement.[26] Courts justify their line of reasoning in this regard as follows - the existence of the deadlock-breaking mechanism, which can be applied to determine outstanding terms, renders the contract sufficiently certain and thus capable of enforcement. As such, we are dealing with a specific type of agreement to negotiate that is intended to be binding and that outlines most of the terms of the final contract. This excludes the enforceability of preliminary agreements such as MOUs or term sheets that outline the terms of the final contract in a non-binding manner.

The grey area in our law lies in the enforceability of agreements to negotiate in good faith that do not contain a deadlock-breaking mechanism. As it presently stands, it appears that these agreements are not enforceable. The core issue sought to be addressed in this thesis was whether the South African law of contract could and should be developed to recognise and enforce these agreements.

6 3 2 Agreements to negotiate that do not contain deadlock-breaking mechanisms

Prior to engaging with the analysis of the enforceability of these agreements to negotiate in South Africa, we observed that an important distinction must be made between agreements to agree and agreements to negotiate. Agreements to negotiate as opposed to unenforceable agreements to agree, do not necessarily guarantee conclusion of the principal contract, but increase the likelihood of the principal contract materialising.[27] With this in mind, we proceed to consider whether an agreement to negotiate outstanding terms in good faith and an agreement solely recording an arrangement to negotiate a second contract in the future could be enforceable even in the absence of a deadlock-breaking mechanism.[28]

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[25] 2005 2 SA 202 (SCA).

[26] See ch 3 (3 2 2 3 (i)).

[27] 3 2 2 3.

[28] 3 2 2 3 (ii).

As indicated above, most of the existing South African case law has utilised the presence of a deadlock-breaking mechanism to determine whether an agreement to negotiate is sufficiently certain to be enforceable. As a result, courts have avoided the need to deal comprehensively with the scope and content of an obligation to negotiate in good faith. Therefore, while courts recognise the validity of an obligation to negotiate in good faith when accompanied by a deadlock-breaking mechanism, they fail to comprehensively describe what it means to negotiate in good faith and what standard parties must comply with before they are entitled to defer to the deadlock-breaking mechanism.

This legal position, as established by the courts, reflects a conservative and mechanical line of reasoning in relation to the requirement of certainty.[29] Courts seek to identify a mechanism whereby the terms of the final contract can be rendered certain, without considering the potential functions sought to be achieved by agreeing to negotiate in good faith.[30] It was argued in this thesis that the South African law of contract can and should be developed to recognise the enforceability of other types of agreements to negotiate even in the absence of a deadlock-breaking mechanism. I set out below how agreements to negotiate in good faith can meet the requirements of certainty and having the *animus contrahendi* even in the absence of a deadlock-breaking mechanism and how considerations of public policy, good faith and *ubuntu* support such a conclusion.

6 4 Proposed developments for the South African law of contract

Against the backdrop of the potential functions that pre-contractual agreements can fulfil,[31] the benefit of comparative insights,[32] and the unique nature of the South African legal system,[33] some conclusions can now be drawn on the desirability and necessity of developing the law on pre-contractual agreements. An important goal in embarking

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[29] 3 2 2 3.

[30] See discussion of the certainty requirement in relation to agreements to negotiate in good faith in South Africa in 3 2 2 3 and compare this with the discussion of foreign law in 3 2 2 1.

[31] See ch 2.

[32] See ch 3 (3 2 2 1); 6 2 above.

[33] See ch 3 (3 2 2 3, 3 3 3 1) and ch 4 (4 2 1) which deals with the nature of the validity requirements and approach to remedies in the South African law of contract.

on a particular course of development would be to make pre-contractual instruments as useful as possible, without giving rise to illogical or problematic developments.

As a basic point of departure, it is accepted that freedom of negotiation and freedom of contract are core principles of South African law. However, this is not as clear cut as it initially seems. The critical question is whether parties should be free to contract out of the so-called "aleatory view of negotiations"[34] or impose a voluntary limitation on their freedom of contract. It has been suggested in other common-law systems that the traditional rules of contract formation should be developed to recognise an intermediate stage of contract formation prior to the conclusion of a principal contract. While this has received support in some courts in America, it has not been recognised in South Africa.

The observations made in this thesis favour the conclusion that the South African law of contract has reached a stage of development where the approach to pre-contractual agreements needs to be re-evaluated. As Mupangavanhu argues:[35]

> "*Everfresh* adds its voice to the growing call that a promise to negotiate in good faith needs to be developed beyond existing precedent, insofar as it relates to agreements to agree whose enforceability is not clear in South African law in the absence of a deadlock breaking clause".[36]

Mupangavanhu goes so far as to support the dissenting minority judgment of Yacoob J, who stated that the court had no choice and was bound by the duty to develop the common law on good faith in a manner that is consistent with the spirit, purport and objects of the Constitution.[37] She argues that "if good faith is indeed the basis of contracts in South Africa, it is inconsistent with sections 8(3) and 39(2) of the Constitution that good faith still plays a peripheral role in resolving contractual disputes,"[38] and she concludes that *Everfresh* was a missed opportunity to develop the common law regarding the doctrine of good faith and to clarify the grey area regarding agreements to negotiate.[39]

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[34] EA Farnsworth *Contracts* 4 ed (2004) 199.

[35] See ch 3.

[36] 2013 *SJ* 170; see 3 5 for further discussions on the views expressed by Mupangavanhu.

[37] 170.

[38] 173.

[39] 171-173.

Although Mupangavanhu's argument cannot be accepted in its entirety, as the court was correct to dismiss the case on procedural grounds, it does draw attention to the fact that if a similar set of facts comes before the courts in the future, they should take the opportunity to consider the development of the common law as suggested in the *Everfresh* case. There it was clear that the parties entered into the agreement to negotiate in good faith with the requisite *animus contrahendi,* but that the common law rules in their current form not only frustrated that objective but were prejudicial to the aggrieved party. However, development of the common law is not without difficulty - how will this be practically executed, and how is one to avoid undermining legal certainty in the South African law of contract?

It was proposed in this thesis that the underlying value of good faith should be utilised to inform the development of the rules relating to the requirement of certainty in order to recognise the enforceability of agreements to negotiate in good faith. This thesis did not seek to extensively analyse the proper role of the value of good faith in the South African law of contract generally, but this concept, as an underlying value of the law of contract, was considered to the extent that it influences the enforceability of agreements to negotiate.[40]

If this sentiment regarding the role of good faith in the development of the legal rules in relation to the validity of agreements to negotiate is accepted and taken forward, it must be acknowledged that good faith is often described in "abstract", "subjective" and "imprecise" terms which is problematic and unfortunately gives rise to legal uncertainty.[41] The court in *Combined Developers v Arun Holdings*[42] concluded, with reference to *Everfresh*, that even if the application of good faith undermines legal certainty, public policy still "embraces the concept of good faith and reasonableness".[43]

It is argued here that much of this legal uncertainty can be avoided, if good faith is understood as an objective value, implicating notions of reasonableness.[44] It is

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[40] See ch 3 (3 5).

[41] McKerrow 2017 *Stell L Rev* 328.

[42] 2015 3 SA 215 (WCC) paras 40-41.

[43] Paras 40-41.

[44] See ch 3 (3 2 2 3 (ii) (a) & 3 5); AM Louw "Yet Another Call for a Greater Role for Good Faith in the South African law of Contract: Can We Banish the Law of the Jungle, While Avoiding the Elephant in the Room?" (2013) 16 *PER* 44; McKerrow 2017 *Stell L Rev* 329, 335.

accepted here that good faith as an objective value is the most sensible source of inspiration for the development of legal rules in relation to agreements to negotiate. Louw explains that "boni mores and *ubuntu* require the recognition of an objectively verifiable ethical standard of conduct in contracting and the enforcement of contracts – 'a minimum threshold of mutual respect'".[45] Good faith as an objective value establishes "an ethical standard of fair dealing between parties which encompasses notions of trust, a moral basis for the enforcement of promises, reciprocity, a duty to act fairly, having regard for the legitimate interests of the other party, and to refrain from conduct that is commercially unacceptable to reasonable and honest people."[46] On this understanding, good faith as an underlying value can be applied to inform the certainty requirement in relation to agreements to negotiate in good faith.

In light of the sentiments expressed above, it is argued that in future judicial deliberations of the contractual enforceability of an obligation to negotiate in good faith, expression can be given to the constitutional mandate to develop the common law in a manner that promotes the values underlying the Constitution and Bill of Rights. The underlying value of good faith, as informed by the value of *ubuntu*, in the context of agreements to negotiate, arguably requires a negotiating party to be cooperative and have regard for the interests of the other party in the course of negotations. The enforcement of an obligation to negotiate gives effect to the underlying value of good faith and *ubuntu* for the following reasons. Firstly, a party is forced to monitor his own conduct in the course of negotiations, and consider the interests of the other party insofar it relates to such party's investment into negotiations, with knowledge of the risk that his failure to do so will render him liable for the aggrieved parties reliance expenditure. Importantly, this is distinct from having regard to the other party's interest, in the broader sense of not pursuing the best deal at the expense of the other party or having to ensure that the terms upon which the principal contract is concluded is equally beneficial for the other party.

Secondly, this type of obligation obliges parties to behave honestly and reasonably towards each other in the course of negotiations and in doing so indirectly contributes towards the facilitation of a more cooperative and fair approach to contractual dealings

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[45] Louw 2013 *PER* 87.

[46] 85.

that is promoted by the underlying values of good faith and *ubuntu*. Lastly, a negotiating party will be prevented from disregarding the interests of the other party, by intentionally avoiding compliance with an agreement that was entered into with the intention to be bound and upon which the other party relied to his detriment and incurred reliance losses.

In light of these observations, should agreements to negotiate that do not contain deadlock-mechanisms give rise to valid contracts, and if so, what should their legal obligations and consequences be. As explained above, South African courts have consistently applied the requirement of a deadlock-breaking mechanism as the test for certainty of agreements to negotiate. The main obstacle we are faced with when enforcing these types of agreements is to determine how we can impart certainty in the absence of a deadlock-breaking mechanism. To assist us in overcoming this obstacle, we first looked to the potential solutions that can be provided by drawing an analogy between agreements to negotiate and (i) pre-emption contracts as well as (ii) contracts granting a unilateral discretion to one of the parties.[47] Secondly we looked to the insight provided by recent case law supporting the enforceability of agreements to negotiate even in the absence of a deadlock-breaking mechanism.[48] In *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd*[49] ("*Everfresh*") the court in an obiter statement recognised that the South African law of contract should be developed to recognise the enforceability of agreements to negotiate in good faith, even in the absence of a deadlock-breaking mechanism.

In *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd*[50] the court also considered the enforceability of this type of agreement to negotiate. Blignault J explained that it is possible to imply standards of reasonableness and good faith into an agreement to negotiate. He went on to reference how courts have implied the standard of the *arbitrium boni viri* to validate contractual provisions

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[47] See ch3 (3 2 2 3 (ii)).

[48] See ch 3; RD McKerrow "Agreements to Negotiate: A Contemporary Analysis" (2017) 28 *Stell LR* 308; D Bhana & N Broeders "Agreements to Agree" (2014) 77 *THRHR* 174; B Mupangavanhu "Yet Another Missed Opportunity to Develop the Common Law of Contract? An Analysis of Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd [2011] ZACC 30" (2013) 27 *SJ* 148.

[49] 2012 1 SA 256 (CC) para 72.

[50] 2012 6 SA 96 (WCC) para 22.

which would otherwise be too uncertain to enforce.[51] What is of crucial significance in this case is that Blignault J recognised the possibility of implying such a standard into agreements to negotiate to render it sufficiently certain to be enforceable. [52] By implying this standard, the obligation to negotiate would oblige parties to act honestly and reasonably in the course of negotiations, and courts are capable of determining whether parties have complied with such a standard. Blignault J also did not regard the absence of a deadlock-breaking mechanism as being fatal to the validity of an agreement to negotiate, and explained that courts could perform a similar function to a deadlock-breaker and would essentially apply the same standards of reasonableness in determining the outstanding terms of the contract. [53]

It is my view that our law has reached a stage of development where it is possible to enforce agreements to negotiate, even in the absence of a deadlock-breaking mechanism. As indicated earlier, considerations of public policy, good faith and *ubuntu* also favour this development and arguably require the enforcement of pre-contractual understandings that foster mutual respect and regard for each other's interests, or at the very least to abstain from bad faith conduct in the course of negotiations.

Determining the most appropriate course of development for the law relating to agreements to negotiate requires us to strike a difficult balance between notions of freedom of contract (which includes freedom not to contract), party autonomy and legal certainty on the one hand, and the principle of *pacta sunt servanda* and the values of good faith and *ubuntu* on the other. With the benefit of academic contributions, it is possible to formulate a practical and sensible approach to the development of the South African law of contract to enforce different types of agreements to negotiate, even in the absence of a deadlock-breaking mechanism.[54]

It is proposed here that the presence of a deadlock-breaking mechanism does not impact on the validity of the agreement to negotiate but rather can operate to influence the type of agreement to negotiate, the nature of the contractual obligations and the type of remedies available.[55] Firstly, the presence of a deadlock-breaking mechanism

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[51] See ch 3 (3 2 2 3 (ii)).

[52] Para 28.

[53] Para 30.

[54] See ch 3 (3 2 2 3 (ii)).

[55] See ch 4; see also McKerrow 2017 *Stell LR* 333.

can be used as an indicator of an intention to be bound by the principal contract notwithstanding outstanding terms. Secondly, the absence of a deadlock-breaking mechanism may indicate the absence of the intention to be bound to conclude the principal contract but parties may nevertheless be bound by an obligation to negotiate in good faith towards the possible conclusion of such a contract. The absence of a deadlock-breaking mechanism is not, however, determinative; there may still be other indicators that parties intend to be bound by an obligation to conclude the substantive agreement notwithstanding the absence of a deadlock-breaking mechanism. In such a case, as discussed, the court may be able to perform the role of deadlock-breaker and in doing so render the agreement sufficiently certain to be capable of enforcement.[56]

On this basis it is proposed that the South African law of contract can be developed to recognise two main types of preliminary agreements. The first type are agreements with open terms (i.e. agreements that record most of the terms of the envisaged contract), and with an express obligation to negotiate in good faith with a view to concluding a final contract, but without a deadlock-breaking mechanism.[57] The enforcement of this type of agreement can be problematic, because it would essentially amount to the enforcement of an agreement to agree that requires the court to determine the outstanding terms on behalf of the parties, thereby undermining party autonomy and freedom of contract, while placing an additional burden on the court.

Nevertheless, this thesis considered and cautiously accepted that the South African law of contract is capable of being developed to give content to, and enforce, this type of agreement to negotiate, even in the absence of a deadlock-breaking mechanism. However, in that event, it must be clear that the parties intended to be bound to conclude a principal agreement and not merely to impose an obligation to negotiate.[58] Most of the contractual terms must be present, and there must be some guidance regarding the intention of the parties in relation to the outstanding terms in the agreement itself, which places the court in a position to determine outstanding terms without displacing party autonomy.[59] It is not however necessary that the parties

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[56] For further discussion of this type of agreement, see ch 3 (3 2 2 3 (ii)) and 6 4 below.

[57] See ch 3 (3 2 2 3 (i) & (ii)).

[58] See ch 3 (3 2 2 3 (ii)) and ch 4 (4 2 1 2 (i)).

[59] See ch 4 (4 2 1 2 (i)).

expressly or tacitly agree to the court determining the outstanding terms. The requirements for this type of agreement to come into existence can therefore be expressed as follows, firstly the parties must clearly manifest an intention to be bound, secondly the court should merely be adding flesh to the bones of an contract that has already been agreed upon by the parties and lastly parties must have provided a guiding standard or framework for the court to determine the outstanding terms. Breach of this type of agreement to negotiate would give rise to specific performance in the form of the court determining outstanding terms.[60]

If the requirements for the first type of agreement to negotiate cannot be met and the absence of a deadlock-breaking mechanism indicates an intention not to be bound by the final contract, then one would be dealing with the second type of agreement to negotiate.[61] The second type of preliminary agreements to negotiate are those that do not bind parties to the conclusion of a final substantive contract, but rather oblige them to negotiate in good faith towards the conclusion of such a principal contract (often called independent agreements to negotiate in good faith).[62] Once parties have complied with their obligation to negotiate in good faith, their contractual obligations will be discharged.[63] Most pre-contractual agreements seeking to impose an obligation to negotiate in good faith will fall into the latter category.

These independent agreements to negotiate must be clearly distinguished from the first type of agreement to negotiate and from agreements to agree.[64] An obligation to negotiate requires of parties to take certain steps in good faith in the course of negotiations (i.e to act honestly and reasonably), but does not guarantee the conclusion of a principal contract. This type of agreement is distinct from an agreement to agree because it removes the inherent discretion that parties have to agree or disagree by imposing a standard of conduct that parties are required to comply with in the course of negotiations. An obligation to negotiate in good faith, will require negotiating parties to act honestly and transparently in the course of negotiations.

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[60] See ch 4 (4 2 1 2 (i)).

[61] See ch 3 (3 2 2 3 (i) (a)).

[62] See ch 3 (3 2 2 3 (ii)).

[63] 3 2 2 3 (ii).

[64] See discussion in 3 2 2 3(ii) (a) on the minority judgement of the Constitutional Court in *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (CC) para 78.

Although it is sometimes suggested that an agreement to negotiate imposes a positive obligation to act in good faith, it is argued here that such an obligation is too far reaching and would considerably hinder commercial transactions insofar as it prevents legitimate hard bargaining by requiring parties to consider the interests and rights of the other party.[65] As such, it is proposed that agreements to negotiate which impose an obligation to negotiate in good faith require parties to abstain from bad faith conduct. This obligation specifically targets deliberate behaviour, such as (i) stringing the other party along in the course of negotiations with no intention of concluding the contract (ii) continuing negotiations merely to prevent a party from concluding the contract with a third party or (iii) proposing terms that are unreasonable or inconsistent with negotiations to force the other party to terminate negotiations. On this understanding, an obligation to negotiate in good faith does not merely require parties to go through the motions of negotiating in order to comply with the aforementioned obligation, on the contrary it requires honesty, reasonableness, and transparency on the part of the negotiating parties regarding the progress of negotiations, the likelihood of contract conclusion, and obliges them to negotiate seriously towards conclusion of the principal contract.[66]

The recognition of an agreement to negotiate that gives rise to intermediate obligations regarding the conclusion of the principal contract, but which does not oblige parties to conclude the final contract, can go a long way in resolving the so-called "judicial hostility" towards pre-contractual agreements generally, and can reduce the uncertainty surrounding the legal consequences of various agreements falling short of a principal contract.

Remedies for breach of this type of agreement can include specific performance and damages.[67] It is acknowledged that the remedy of specific performance is the primary remedy for breach of contract in South African law. This is problematic in the context of independent agreements to negotiate that do not guarantee conclusion of the final contract. Specific performance for breach of an obligation to negotiate entails an order compelling parties to negotiate in good faith. Once parties have complied with this obligation, it will be discharged, even if negotiations fail to give rise to a contract.

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[65] 3 2 2 3 (ii) (b).

[66] 3 2 2 3(ii) (b).

[67] See ch 4.

This can give rise to the following problems. Firstly it can be difficult for courts to monitor and ensure compliance with an order compelling parties to negotiate towards conclusion of the contract under negotiation. Secondly, it is acknowledged that this remedy may have limited value for a party wanting negotiations to result in the principal contract, because in most situations where a deadlock has been reached in negotiations, the relationship between the parties has broken down and even good faith negotiations will fail to remedy the breakdown.

Notwithstanding the imperfections associated with a remedy of specific performance in this context, the existence of a contractual obligation, that is capable of being specifically enforced by a court, will force parties to give thought to their conduct in negotiations and discourage opportunistic behaviour. Furthermore, parties may still have a claim for damages at their disposal to remedy losses suffered as a result of their reliance on the fact that the other party would negotiate in good faith towards conclusion of the contract, and on that basis made relationship-specific investments in the negotiations. The damages available for breach of this type of agreement to negotiate should be limited to reliance damages, and expectation damages should specifically be excluded, because the agreement to negotiate did not guarantee conclusion of a contract and courts are not in a position to speculate regarding what the terms of the principal contract would have been. By awarding this type of claim, courts would be giving effect to the underlying value of good faith, because it encourages a negotiating party to have considered the interests of the other party insofar as that party's investment into the negotiations are concerned.

However, even if these two types of agreements to negotiate are recognised, it still does not eliminate the need for development in other areas of the law to provide remedies for conduct during the pre-contractual phase, particularly in circumstances where a pre-contractual agreement has been concluded (whether binding or not). This leads onto the next aspect which we considered, namely pre-contractual liability arising from sources other than contract.

6 5 Pre-contractual liability arising from sources other than contract

Even if we recognise that contractual obligations should arise from specific types of pre-contractual agreements, it is still necessary to consider whether pre-contractual liability can arise from non-contractual sources of law.

With the benefit of comparative analysis, it is possible to conclude that both the South African law of unjustified enrichment and the law of delict can and should be developed to provide a remedy in specific circumstances for losses suffered or unjustified gains being obtained as a result of a party's conduct during the pre-contractual phase.[68] Both international instruments and civil-law systems such as Germany make provision for liability for certain forms of conduct during the pre-contractual phase.[69] It is proposed that South African law should follow a similar course of development, but rather than importing an independent doctrine of *culpa in contrahendo* it should develop the existing rules of the law of delict and the law of unjustified enrichment.

The law of delict can be developed to recognise an action for misrepresentations regarding the conclusion of a future contract in circumstances where no contract ultimately materialises. Breaking off negotiations in circumstances where negotiations have reached an advanced stage and one party has made a fraudulent or even negligent misrepresentation regarding the conclusion of a contract which the other party has relied upon it to his detriment should give rise to a remedy for the aggrieved party aimed at placing the party in the position he would have been in had the negligent misrepresentation not been made. This type of remedy will be available regardless of whether a pre-contractual agreement has been concluded, but the existence of a pre-contractual agreement can serve as evidence of the misrepresentation and render the reliance reasonable. While the remedy in both the contractual and delictual context may be reliance damages, in a contractual context an award of reliance damages will be based on breach of contractual obligation to negotiate in good faith, while in the delictual context, reliance damages will be awarded for breach of a legal duty to negotiate in good faith which is conceptually distinct.

Public policy in South Africa has evolved to promoting greater fairness and reasonableness in contracting,[70] and more specifically is applied to give greater expression to the value of good faith. We saw how the development of an action for negligent misrepresentation to include representations regarding the conclusion of a

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[68] See ch 5.

[69] 5 2 3.

[70] A Hutchison "Liability for Breaking off Contractual Negotiations" (2012) 129 *SALJ 1*29-130; *Barkhuizen v Napier* 2007 5 SA 323 (CC).

contract in circumstances where no contract materialises can discourage blameworthy conduct in the course of negotiations.[71] This in turn promotes greater fairness and reasonableness in negotiations and indirectly gives effect to the value of good faith by requiring parties to maintain a certain standard of conduct in negotiations and to have regard to the interests of the other party in circumstances where a legal duty arises.[72] Developing the law of delict in this manner will provide a remedy in circumstances where a person suffers losses in reliance on the blameworthy conduct of the other party in the course of negotiations.

However, there can also be circumstances where the loss cannot be attributed to the blameworthy conduct of one of the parties, but rather one party is unjustifiably enriched and at the expense of another in the course of negotiations. It is the law of unjustified enrichment that must be developed to cater for these situations. We observed how the law of unjustified enrichment can and should be developed to provide for situations where one party performs in anticipation of a future obligation which subsequently fails to materialise.

Developing the law of delict and the law of unjustified enrichment in this way provides a well-constructed legal framework for pre-contractual liability that will in appropriate but limited circumstances provide a remedy to a party who suffers loss or seeks restitution of unjustified gains made during the pre-contractual phase. The law in South Africa has reached such a stage of development, particularly since the advent of the Constitution, where it is no longer appropriate for parties to be able to conduct themselves in a manner that does not accord with the value of good faith in the course of negotiations and thereby cause harm to the other party without incurring liability. These developments may further promote efficient exchanges, since parties will be able to invest in negotiations freely, knowing that there are remedies at their disposal. This will also discourage opportunistic or overreaching behaviour by parties in the course of negotiations which will only increase the likelihood of commercial transactions being concluded.

6 6 Concluding observations

[71] See ch 5 (5 2 4 1).

[72] See ch 5 (5 2 4 1).

It is clear that agreements to negotiate, much like pre-emption agreements and agreements granting a unilateral discretion, can perform a valuable commercial function and that the rules of the law of contract relating to agreements to negotiate are thus in need of development. This development is justified both by the needs of modern commerce as well as public policy, as influenced by good faith and *ubuntu*, which ultimately demands that parties that voluntarily conclude an agreement to negotiate comply with the obligation to act honestly and reasonably in the course of negotiations. We also saw how the South African law of delict and law of unjustified enrichment could benefit from development so as to provide for pre-contractual liability, particularly in circumstances where a pre-contractual agreement has been concluded. Hopefully South African courts will soon recognise the need for and utility of developing the law to provide a clearer legal framework in which negotiations take place. Such a legal framework will promote a certain level of conduct in the course of negotiations and may encourage investment in negotiations, which will in turn could result in more efficient commercial contracting.

Appendix A

Confidentiality agreement (private company acquisitions): Cross-border

by Practical Law Global[1]

Standard documents | **Maintained** | Australia, Brazil, Canada, China, England, France, Germany, Hong Kong - PRC, India, Indonesia, Italy, Japan, Mexico, Nigeria, Russian Federation, Singapore, **South Africa**, South Korea, Spain, The Netherlands, Turkey, United Arab Emirates, United Kingdom, United States, Wales

A jurisdiction-neutral standard form **confidentiality agreement** (also known as a non-disclosure **agreement** or **NDA**) for use in connection with a proposed sale of the entire issued share capital (or equivalent equity interest) or the business and assets of a company incorporated and registered outside the UK, where both the buyer and seller are companies. This document is in the form of an **agreement** rather than a letter.

This document has been adapted from *Standard document, **Confidentiality agreement**: corporate seller: acquisitions* and *Standard document, **Confidentiality** letter: corporate seller: acquisitions* to provide a plain English, UK-style jurisdiction neutral starting point for local counsel to adapt in cross-border transactions.

For a form of **confidentiality agreement** to use in connection with cross-border asset and business acquisitions, see *Standard document, **Confidentiality agreement** (asset purchases): Cross-border*.

The document contains integrated drafting notes discussing key legal, negotiating and drafting issues. Jurisdiction-specific drafting notes (updated periodically) provide practical information for Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Mexico, The Netherlands, Nigeria, Russian Federation, Singapore, South Africa, South Korea, Spain, Turkey, United Arab Emirates, the UK (England and Wales) and the United States.

[1] Practical Law Global "UK Standard Document 5-101-4188" (2019) Thomson Reuters <https://uk.practicallaw.thomsonreuters.com/5-101-4188> (accessed 12-12-2019).

This **agreement** is dated [DATE]

PARTIES

(1)[FULL COMPANY NAME] incorporated and registered in [COUNTRY OF INCORPORATION] with company number [NUMBER] whose registered office is at [REGISTERED OFFICE ADDRESS] **(Seller)**

(2)[FULL COMPANY NAME] incorporated and registered in [COUNTRY OF INCORPORATION] with company number [NUMBER] whose registered office is at [REGISTERED OFFICE ADDRESS] **(Buyer)**

BACKGROUND

(A) The Buyer [is discussing **OR** intends to enter into discussions **OR** is negotiating] with the Seller in connection with the Proposed Transaction.

(B) The Seller [and its Group] wish to ensure that any Confidential Information disclosed to the Buyer in connection with the Proposed Transaction remains confidential and is not used by the Buyer for any purpose other than the Permitted Purpose.

(C) The parties have agreed to comply with this **agreement** in connection with the use and disclosure of the Confidential Information.

AGREED TERMS

1. INTERPRETATION

1.1 The definitions and rules of interpretation in this clause apply in this **agreement**.

Authorised Contact: has the meaning given in: *Clause 6.1***.**

Business Day: a day other than a [Saturday, Sunday or public holiday in [COUNTRY]] when banks in [CITY] are open for business.:

Confidential Information: has the meaning given in *Clause 2.1*.

Copies: copies of Confidential Information including any document, electronic file, note, extract, analysis, study, plan, compilation or any other way of representing or recording or recalling information which contains, reflects or is derived or generated from Confidential Information.

Group: in relation to a company (wherever incorporated), that company, any company of which it is a Subsidiary from time to time (its holding company) and any other Subsidiaries from time to time of that company or its holding company. Each company in a Group is a **member of the Group**.

Indemnified Person: has the meaning ascribed to it in: *Clause 10.1***.**

[**Key Employee:** any individual who is, at any time during the negotiations relating to the Proposed Transaction, an employee holding an executive or managerial position with, or an officer of, the Seller or any other member of the Seller's Group.]

Permitted Purpose: considering, evaluating, negotiating or advancing the Proposed Transaction.

Permitted Recipient: any person referred to in *Clause 4.1* to whom Confidential Information is disclosed by, or at the request of, the Buyer.

Proposed Transaction: the proposed acquisition by the Buyer of [[the [business and assets **OR** entire share capital] of the Target **OR** [DESCRIPTION OF THE TRANSACTION]].

Restricted Customer: has the meaning ascribed to it in: *Clause 9.1(d)***.**

Restricted Period: the period commencing on the date of this agreement and ending on the earlier of the: termination of the Buyer's undertakings and obligations in this agreement in accordance with: *Clause 13***; and date being [NUMBER] [days OR months] after the date of this agreement.:**

Subsidiary: in relation to a company wherever incorporated (**a holding company**), any company in which the holding company (or persons acting on its or their behalf) directly or indirectly holds or controls either:

a. [a majority of the voting rights exercisable at shareholder meetings of that company]; or

b. [the right to appoint or remove a majority of its board of directors],

and any company which is a Subsidiary of another company is also a Subsidiary of that company's holding company. [Unless the context otherwise requires, the application of the definition of Subsidiary to any company at any time shall apply to the company as it is at that time.]

Target: [FULL COMPANY NAME].

Usual Business Hours: has the meaning ascribed to it in *Clause 19.5*.

1.2 Clause headings do not affect the interpretation of this **agreement**.

1.3 A reference to **this agreement** is a reference to this **agreement** as varied or novated in accordance with its terms from time to time.

1.4 Unless the context otherwise requires, words in the singular shall include the plural and the plural shall include the singular.

1.5 [Unless the context otherwise requires, a reference to one gender shall include a reference to the other genders.]

1.6 A **person** includes a natural person, corporate or unincorporated body (whether or not having separate legal personality) and that person's successors and permitted assigns.

1.7 A reference to a **party** shall include that party's successors and permitted transferees.

1.8 A reference to a **company** shall include any company, corporation or other body corporate, wherever and however incorporated or established.

1.9 Unless expressly provided otherwise in this **agreement**, a reference to **writing** or **written** includes fax and email.

1.10 Any words following the terms **including**, **include**, **in particular**, **for example**, or any similar expression shall be construed as illustrative and shall not limit the sense of the words, description, definition, phrase or term preceding those terms.

1.11 A reference to a law is a reference to it as [amended, extended or re-enacted from time to time **OR** it is in force at the date of this **agreement**] [provided that, as between the parties, no such amendment, extension or re-enactment made after the date of this **agreement** shall apply for the purposes of this **agreement** to the extent that it would impose any new or extended obligation, liability or restriction on, or otherwise adversely affect the rights of, any party].

1.12 A reference to a law shall include all subordinate legislation made [from time to time **OR** as at the date of this **agreement**] under that law.

1.13 Any obligation on a party not to do something includes an obligation not to allow that thing to be done.

2. CONFIDENTIAL INFORMATION

2.1 In this **agreement**, **Confidential Information** means all confidential or proprietary information (however recorded or preserved) that is disclosed or made available (in any form or medium), directly or indirectly, by the Seller [or any member of its Group] (or any of [its **OR** their respective] employees, officers, agents or advisers) to the Buyer [or any member of its Group] (or any of [its **OR** their respective] employees, officers, agents or advisers) [whether before, on or after the date of this **agreement**,] in connection with the Proposed Transaction, including:

(a) the fact that the Seller is considering entering into the Proposed Transaction, or that discussions are taking (or have taken) place concerning the Proposed Transaction;

(b) the existence and contents of this **agreement**;

(c) all confidential or proprietary information relating to the Proposed Transaction, the Target[, the Seller] or any member of [its **OR** their respective] Group[s] and the affairs, financial or trading position, assets, intellectual property rights, customers, clients, suppliers, employees, plans, operations, processes, products, intentions or market opportunities of the Target[, the Seller] or any member of [its **OR** their respective] Group[s];

(d) the know-how, designs, trade secrets, technical information or software of the Target[, the Seller] or any member of [its **OR** their respective] Group[s];

(e) any other information that is identified as being of a confidential or proprietary nature; and

(f) any findings, data or analysis derived from such information,

but excluding any information referred to in *Clause 2.2*.

2.2 Information is not Confidential Information if:

(a) it is, or becomes, generally available to the public other than as a direct or indirect result of the information being disclosed by the Buyer or any other person in breach of this **agreement** [(except that any compilation of otherwise public information in a form not publicly known shall nevertheless be treated as Confidential Information)];

(b) the Buyer can [prove **OR** establish to the reasonable satisfaction of the Seller] that it received the information from a source that is not connected with the Seller, the Target [or their respective Groups] and that such source was not under any obligation of confidence in respect of that information;

(c) the Buyer can [prove **OR** establish to the reasonable satisfaction of the Seller] that the information was lawfully in its possession before it was disclosed by the Seller or the Target (or on its or their behalf) and the Buyer was not under any obligation of confidence in respect of that information; or

(d) the parties agree in writing that the information is not confidential.

3. BUYER'S OBLIGATIONS

3.1 In consideration for the Seller agreeing, conditional upon the entry into this **agreement**, to make Confidential Information available to the Buyer, the Buyer acknowledges that all Confidential Information is confidential and undertakes to the Seller [(and each member of its Group]) that it shall ([and will procure that each member of its Group shall]):

(a) keep the Confidential Information secret and confidential;

(b) not use or exploit the Confidential Information in any way, except for the Permitted Purpose;

(c) ensure that all Confidential Information is kept in a secure place and apply the same security measures and degree of care to the Confidential Information as it applies to its own confidential information;

(d) not directly or indirectly disclose or otherwise make available any Confidential Information in whole or in part to any person, except as expressly permitted by, and in accordance with, the terms of this **agreement**;

(e) not make any Copies, except as expressly permitted by, and in accordance with, the terms of this **agreement**;

(f) [not to use, reproduce, transform or store any of the Confidential Information in an externally accessible computer or electronic information retrieval system or transmit it in any form by any means outside its usual places of business;]

(g) keep confidential and not disclose to any person, except as expressly permitted by this **agreement**, the fact that Confidential Information has been made available to the Buyer or that any discussions may occur or have occurred between the Buyer and the Seller relating to Confidential Information or this **agreement**;

(h) [use [its best **OR** all reasonable] endeavours to] ensure that no person gets access to any Confidential

Information from the Buyer [or any member of its Group] or [its **OR** their respective] officers, employees or agents, except as expressly permitted by, and in accordance with, the terms of this **agreement**; and

(i) inform the Seller immediately on becoming aware, or suspecting, that Confidential Information has been disclosed to, or otherwise obtained by, an unauthorised third party.

3.2 The Buyer may make only such Copies as are strictly necessary for the Permitted Purpose and shall:

(a) clearly mark all Copies as confidential;

(b) ensure that all Copies can be separately identified from its own information; and

(c) [use [its best **OR** all reasonable] endeavours to] ensure that all Copies within its control are protected against theft or unauthorised access.

3.3 Upon receipt of a written request from the Seller, the Buyer shall (to the extent reasonably practicable), promptly provide the Seller with a written record of:

(a) the location of all Confidential Information that has been supplied to the Buyer or a Permitted Recipient;

(b) all Copies made by the Buyer or a Permitted Recipient (excluding any Copies which contain insignificant extracts from or references to Confidential Information) and where such Copies are held; and

(c) the names and addresses of every person to whom Confidential Information has been disclosed by (or at the request of) the Buyer [together with the **confidentiality agreements** signed by such persons complying with *Clause 4.2(b)*].

4. PERMITTED DISCLOSURE

4.1 Provided it complies with its obligations under *Clause 4.2*, the Buyer may disclose Confidential Information to:

(a) its officers or employees [(or those of its Group)] that need to know the relevant Confidential Information for the Permitted Purpose;

(b) the professional advisers or consultants engaged to advise the Buyer [(or any member of its Group)] in connection with the Proposed Transaction;

(c) its bankers, potential investors (and their respective professional advisers or consultants) for the purpose of securing finance for the Proposed Transaction; and

(d) any person whom the Seller agrees in writing may receive the relevant Confidential Information.

4.2 Where Confidential Information is disclosed to a Permitted Recipient, the Buyer shall:

(a) inform the Permitted Recipient[in writing], before or at the same time the Confidential Information is disclosed, of the confidential nature of the Confidential Information[, except where the Permitted Recipient is subject to professional obligations to maintain the **confidentiality** of the Confidential Information];[and]

(b) procure that the Permitted Recipient shall, in relation to any Confidential Information disclosed to it, comply with this **agreement** as if it were the Buyer [and, if the Seller so requests, procure that the Permitted Recipient enters into a **confidentiality agreement** with the Seller on terms equivalent to those contained in this **agreement**][; and

(c) at all times, be responsible for each Permitted Recipient's compliance with the terms of this **agreement** as if the Permitted Recipient were the Buyer.

5. MANDATORY DISCLOSURE

5.1 Subject to the provisions of this *Clause 5*, the Buyer may disclose Confidential Information to the minimum extent required by:

(a) an order of any court of competent jurisdiction or any regulatory, judicial, governmental or similar body, or any taxation authority of competent jurisdiction;

(b) the rules of any listing authority or securities exchange on which the shares of the Buyer [(or any member of its Group)] are listed or traded; or

(c) the laws or regulations of any country to which the affairs of the Buyer ([or any member of its Group)] are subject.

5.2 Before the Buyer discloses any information under *Clause 5.1*, the Buyer shall (to the extent permitted by law) [use [its best **OR** all reasonable] endeavours to]:

(a) inform the Seller of the full circumstances of the required disclosure and the Confidential Information that must be disclosed;

(b) take all such steps as may be reasonable and practicable in the circumstances to agree the contents of the required disclosure with the Seller before it is made;

(c) consult with the Seller as to possible steps to avoid or limit the required disclosure and to take those steps where they would not result in significant adverse consequences to the Buyer;

(d) gain assurances as to **confidentiality** from the body or authority requiring the disclosure; and

(e) where the disclosure is by way of public announcement, agree the wording of such announcement with the Seller before it is made.

5.3 The Buyer shall co-operate with the Seller (at the Seller's cost and expense) if the Seller decides to bring any legal or other proceedings to challenge the validity of the requirement to disclose Confidential Information pursuant to *Clause 5.1*.

5.4 If the Buyer is unable to inform the Seller before Confidential Information is disclosed pursuant to *Clause 5.1*, the Buyer shall (to the extent permitted by law) inform the Seller of the full circumstances of the disclosure and the information that has been disclosed immediately after such disclosure has been made.

6. AUTHORISED CONTACT

6.1 All communications with the Seller concerning the Proposed Transaction shall be addressed to [NAME] at [CONTACT DETAILS] (**Authorised Contact**).

6.2 Except with the prior written consent of the Seller, neither the Buyer nor anyone acting on its behalf, shall contact or communicate with any officers, employees, consultants, advisers, landlords, bankers, customers, clients or suppliers of the Seller or any other member of its Group in connection with the Proposed Transaction[, except for the Authorised Contact].

7. RETURN OF CONFIDENTIAL INFORMATION

7.1 If discussions in relation to the Proposed Transaction cease, or the Seller so requests at any time by notice in writing to the Buyer, the Buyer shall immediately:

(a) return to the Seller, destroy or permanently erase (including to the extent legally and technically practicable, from its computer(s) and communications systems and devices or from systems and data storage services provided by third parties) all documents and materials containing, reflecting, incorporating or based on any Confidential Information that have been supplied to, or generated by, the Buyer or any Permitted Recipient, including all Copies[, other than any Copies that:

(i) contain insignificant extracts from, or references to, Confidential Information;
(ii) are only Copies because they refer to the Proposed Transaction;
(iii) are referred to under *Clause 7.2*; or
(iv) contain no Confidential Information other than information disclosed under *Clause 5*];

(b) procure that each Permitted Recipient takes the steps referred to in *Clause 7.1(a)* in relation to all Confidential Information received by it; and

(c) confirm in writing to the Seller [(through a certificate signed for the Buyer by one of its directors or other senior officers)] that it has complied with its obligations under this *Clause 7.1*.

7.2 Nothing in *Clause 7.1* shall require the Buyer to return, destroy or permanently erase (or procure the return, destruction or permanent deletion of) any documents or materials containing, reflecting, incorporating, or based on Confidential Information, including any Copies, that the Buyer or any Permitted Recipient is required to retain by applicable law, or to satisfy the requirements of any regulatory authority or body of competent jurisdiction, or the rules of any listing authority or securities exchange to which the Buyer or the Permitted Recipient is subject [or to comply with any applicable internal policy of the Buyer or of its Group]. The provisions of this **agreement** shall continue to apply to any documents and materials retained by the Buyer or any Permitted Recipient pursuant to this *Clause 7.2*.

8. SELLER'S OBLIGATIONS

8.1 Subject to *Clause 8.2*, the Seller undertakes that it shall [(and shall procure that each member of its Group shall)] keep secret and confidential the Buyer's interest in the Proposed Transaction and shall take all reasonable precautions to ensure that such information remains confidential.

8.2 The Seller may disclose the Buyer's interest in the Proposed Transaction to:

(a) any officers or employees of the Seller['s Group] to the extent necessary for the Permitted Purpose;
(b) its professional advisers or consultants engaged to advise in connection with the Proposed Transaction;
(c) any person whom the Buyer agrees in writing may receive the relevant information;
(d) its bankers, investors or funders (and their respective professional advisers or consultants) to the extent necessary for the Permitted Purpose;

(e) the [minimum] extent required [or requested] by an order of any court of competent jurisdiction or any regulatory, judicial, governmental or similar body or any taxation authority of competent jurisdiction, or the rules of any listing authority or securities exchange on which the shares of the Seller (or any member of its Group) are listed or traded; and

(f) the [minimum] extent required by the laws or regulations of any jurisdiction to which the affairs of the Seller [(or any member of its Group)] are subject.

8.3 [The Seller shall use all reasonable endeavours to procure that any person to whom it has disclosed the Buyer's interest in the Proposed Transaction keeps that information secret and confidential (save where the disclosure is made in accordance with *Clause 8.2(e)* or *Clause 8.2(f)*).]]

9. RESTRICTIONS ON THE BUYER

9.1 The Buyer undertakes to the Seller [(and each member of the Seller's Group)] that except with the prior written consent of the Seller, it shall not [(and shall procure that no member of its Group shall)] at any time during the Restricted Period:

(a) initiate or participate in any discussions, or have contact of any kind, with any officer or employee of the Seller [(or those of any member of its Group)] relating to the Proposed Transaction [except as permitted by *Clause 6*, or otherwise in the ordinary course of business between the Seller [(or any member of its Group)] and the Buyer];

(b) employ or offer to employ, or enter into a contract for the services of, a Key Employee or procure or facilitate the making of any such offer by any other person;

(c) entice, solicit or procure any Key Employee to leave the employment of the Seller [(or any member of its Group)], or make any attempt to do so, whether or not the Key Employee would commit a breach of contract in leaving their employment;

(d) [canvass, solicit or otherwise seek the custom of, or have any dealings with any person who is or who has been at any time during the period of [NUMBER] months immediately preceding the date of this **agreement**, a client or customer of the Seller [(or any member of its Group)] (**Restricted Customer**), in relation to the supply of goods, products or services the same as or similar to those supplied by the Seller [(or any member of its Group)]; or]

(e) [induce or attempt to induce a Restricted Customer to cease conducting or to reduce the amount of business conducted with, or to vary adversely the terms upon which it conducts business with, the Seller [(or any member of its Group)], or do any other thing which is reasonably likely to have such an effect.]

9.2 The undertakings in *Clause 9.1* are intended for the benefit of, and shall be enforceable by the Seller [and each member of the Seller's Group] [together with any future buyers of the [[business and assets **OR** entire share capital] of the Target] and apply to actions carried out by the Buyer [or any member of its Group] in any capacity (including as shareholder, partner, director, principal, consultant, officer, agent or otherwise) and whether directly or indirectly, on its own behalf or on behalf of, or jointly with, any other person.

9.3 Each of the covenants in *Clause 9.1*:

(a) is considered fair and reasonable by the parties;

(b) is a separate undertaking by the Buyer; and

(c) shall be enforceable separately and independently of any person's right to enforce any one or more of the other undertakings contained in that clause.

9.4 [The placing of an advertisement of a post available to members of the public generally and the recruitment of a person through an employment agency shall not constitute a breach of *Clause 9.1* provided that neither the Buyer [nor any member of its Group,] nor any of [its **OR** their respective] officers or employees encourages or advises such agency to approach a Key Employee.]

10. INDEMNITY

10.1 The Buyer shall (in addition to, and without affecting, any other rights or remedies the Seller may have) indemnify, keep indemnified and hold the Seller [and each member of its Group (each an **Indemnified Person**)] harmless from and against all actions, claims, demands, liabilities, damages, costs, losses or expenses [(including but not limited to any consequential losses, loss of profit, loss of reputation and all interest, penalties, legal and other professional costs and expenses), directly or indirectly **OR** (including any [reasonable] legal and other professional costs and expenses), provided that the Buyer shall not be liable to [the Seller **OR** an Indemnified Person] for any consequential or indirect damages such as, but not limited to, loss of profit, loss of reputation and all interest and penalties,] arising out of or in connection with any breach or non-performance by the Buyer or any Permitted Recipient, of any of the provisions under this **agreement**.

10.2 If a payment due from the Buyer under *Clause 10.1* is subject to tax (whether by way of direct assessment or withholding at its source), the [Seller **OR** Indemnified Person] shall be entitled to receive from the Buyer such amounts as shall ensure that the net receipt after tax of the [Seller **OR** the relevant Indemnified Person] in respect of the payment is the same as it would have been were the payment not subject to tax.

11. RESERVATION OF RIGHTS AND BUYER'S ACKNOWLEDGEMENT

11.1 This **agreement** and the supply of Confidential Information shall not constitute an offer by, or a representation or warranty on the part of, the Seller [or any member of its Group] to enter into the Proposed Transaction or any further **agreement** with the Buyer [(or any other member of its Group)].

11.2 Nothing in this **agreement** or its operation shall constitute an obligation on either party to continue discussions or negotiations in connection with the Proposed Transaction, or an obligation on the Seller[or any member of its Group] to disclose any information to the Buyer, whether Confidential Information or otherwise.

11.3 All rights in the Confidential Information are reserved and none of the Confidential Information shall be the property of the Buyer. The disclosure of Confidential Information to the Buyer shall not give the Buyer or any other person any licence or other right whatsoever in respect of any Confidential Information beyond the rights expressly set out in this **agreement**.

11.4 The Buyer acknowledges that the Confidential Information may not be accurate or complete and neither

the Seller[nor any member of the Seller's Group,] nor [its **OR** their respective] employees, agents or advisers make any warranty or representation (whether express or implied) concerning the Confidential Information, its accuracy or completeness or are under any obligation to update or correct any inaccuracy in the Confidential Information supplied to the Buyer or are otherwise liable to the Buyer for the Confidential Information.

11.5 The Buyer shall be liable for the actions or omissions of the Permitted Recipients in relation to Confidential Information as if they were the actions or omissions of the Buyer.

12. [**INSIDE INFORMATION** The Buyer acknowledges that some or all of the Confidential Information may be unpublished, price-sensitive information and that the Buyer is aware of its obligations relating to such information under the law and regulations applicable to it.]

13. DURATION

13.1 This **agreement** shall terminate upon closing of the Proposed Transaction.

13.2 Save as provided in *Clause 13.1*, this **agreement** shall continue in full force and effect for a period of [NUMBER] [years **OR** months] from the date of this **agreement**. The parties' obligations under this **agreement** shall not be affected by any termination of the negotiations or discussions between the Buyer and the Seller in relation to the Proposed Transaction.

13.3 Termination of the obligations and undertakings in this **agreement** will not affect any accrued rights or remedies to which a party is entitled.

14. ANNOUNCEMENTS

Any announcement or circular relating to the existence or the subject matter of this **agreement** shall (subject to *Clause 5*) first be approved by both parties as to its content, form and manner of publication.

15. ASSIGNMENT AND OTHER DEALINGS

15.1 The Buyer confirms that it is:

(a) acting on its own behalf in relation to the Proposed Transaction and not as a broker or agent, or otherwise for the benefit, of any other person; and

(b) not seeking to enter into the Proposed Transaction the with a view to resale.

15.2 [Subject to *Clause 15.3*, neither **OR** Neither] party shall assign, transfer or deal in any other manner with any or all of its rights and obligations under this **agreement** [or any document referred to in it].

15.3 [The Seller may assign its rights under this **agreement** to a purchaser of the [business and assets **OR** entire share capital] of the Target and such assignee shall be entitled to enforce this **agreement** as if it were the Seller.]

16. ENTIRE AGREEMENT

16.1 This **agreement** [(together with the documents referred to in it)] constitute[s] the entire **agreement**

between the parties [in relation to the obligations of the Buyer regarding Confidential Information] and supersede[s] and extinguish[es] all previous discussions, correspondence, negotiations, drafts, **agreements**, promises, assurances, warranties, representations and understandings between them, whether written or oral, relating to [[its **OR** their] subject matter **OR** Confidential Information].

16.2 Each party acknowledges that in entering into this **agreement** it does not rely on[, and shall have no remedies in respect of,] any statement, representation, assurance or warranty (whether made innocently or negligently) that is not set out in this **agreement**. Each party agrees that it shall have no claim for innocent or negligent misrepresentation [or negligent misstatement] based on any statement in this **agreement**.

16.3 If the Proposed Transaction proceeds, the Buyer shall enter into a sale and purchase **agreement** under which the Buyer acknowledges that it has not been induced to enter into that **agreement** by any warranty or representation other than as set out in that **agreement** and the Buyer shall have no rights or remedies in respect of any warranty or representation (whether made innocently or negligently) that is not set out in that **agreement**.

16.4 [Nothing in this *Clause 16* operates to limit or exclude any liability for fraud.]

17. VARIATION AND WAIVER

17.1 No variation of this **agreement** shall be effective unless it is in writing and signed by all the parties (or their authorised representatives).

17.2 No failure or delay by any party to exercise any right or remedy provided under this **agreement** or by law shall constitute a waiver of that or any other right or remedy nor shall it prevent or restrict the further exercise of that or any other right or remedy. No single or partial exercise of such right or remedy shall prevent or restrict the further exercise of that or any other right or remedy.

17.3 A waiver of any right or remedy under this **agreement** or by law, or any consent given under this **agreement**, is only effective if it is given in writing by the person giving such waiver or consent. Any such waiver or consent shall apply only to the circumstances for which it is given.

18. COSTS

Except as expressly provided in this **agreement** [(or otherwise agreed in writing by the parties)], each party shall pay its own costs and expenses incurred in connection with the Proposed Transaction, including the negotiation, preparation, execution and performance of this **agreement** (and any document referred to in it), and the evaluation and review of the Confidential Information.

19. NOTICES

19.1 For the purposes of this *Clause 19* [(but subject to *Clause 19.6*)], notice includes any other communication.

19.2 A notice given to a party under or in connection with this **agreement**:

(a) shall be in writing and in [English **OR** [SPECIFY LANGUAGE(S)]] (or be accompanied by an accurate translation into [English **OR** [SPECIFY LANGUAGE(S)]]);

(b) [shall be signed by or on behalf of the party giving it;]

(c) shall be sent to the relevant party for the attention of the contact and to the address[, email address] [or] [fax number] specified in *Clause 19.3*, or to such other contact and address[, email address] [or] [fax number] as that party may notify to the other in accordance with *Clause 19.4*; and

(d) shall be:

(i) delivered by hand;

(ii) sent by [fax] [or] [email];

(iii) sent by pre-paid first class post or another next working day delivery service [providing proof of [postage **OR** delivery]; or

(iv) sent by pre-paid airmail or by reputable international overnight courier (if the notice is to be served by post to an address outside the country from which it is sent) [providing proof of [postage **OR** delivery]; and

(e) [unless proved otherwise]is deemed received as set out in *Clause 19.5*.

19.3 The details for service of notices are:

(a) [SELLER]

(i) address: [ADDRESS]

(ii) for the attention of: [NAME]

(iii) [fax number: [FAX NUMBER]]

(iv) [email: [EMAIL ADDRESS]]

(b) [BUYER]

(i) address: [ADDRESS]

(ii) for the attention of: [NAME]

(iii) [fax number: [FAX NUMBER]]

(iv) [email: [EMAIL ADDRESS]]

19.4 A party may change its details for service of notices specified or referred to in *Clause 19.3* by giving notice in writing to the other party[, provided that the address for service is an address in [SPECIFY COUNTRY] following any such change]. Any change notified pursuant to this clause shall take effect at [9.00 am in the place of receipt] on the later of:

(a) the date (if any) specified in the notice as the effective date for the change; and

(b) [five] Business Days after receipt of the notice of change.

19.5 A notice is deemed to have been received (provided that all other requirements in this *Clause 19* have been satisfied):

(a) if delivered by hand, on signature of a delivery receipt [or at the time the notice is left at the address]; or

(b) if sent by [fax] [or] [email], at the time of transmission; or

(c) if sent by pre-paid first class post or another next working day delivery service [providing proof of [postage **OR** delivery]] to an address in [SPECIFY LOCATION], at 9.00 am on the [second] Business Day after posting [or at the time recorded by the delivery service]; or

(d) if sent by pre-paid airmail [providing proof of [postage **OR** delivery]] to an address outside the country from which it is sent, at 9.00 am on the [fifth] Business Days after posting [or at the time recorded by the delivery service]; or

(e) if sent by reputable international overnight courier to an address outside the country from which it is sent, on signature of a delivery receipt [or at the time the notice is left at the address],

PROVIDED that if deemed receipt under the previous paragraphs of this *Clause 19.5* would occur outside the Usual Business Hours, the notice shall be deemed to have been received when Usual Business Hours next recommence. For the purposes of this clause, **Usual Business Hours** means 9.00 am to 5.30 pm local time on any day which is not a [Saturday,] [Sunday] [or] public holiday in the place of receipt of the notice [(which, in the case of service of a notice by [fax] [or] [email] shall be deemed to be the same place as is specified for service of notices on the relevant party by hand or post). For the purposes of this clause, all references to time are to local time in the place of deemed receipt.

19.6 [This *Clause 19* does not apply to the service of any proceedings or other documents in any legal action [or, where applicable, any arbitration or other method of dispute resolution].]

19.7 [A notice given under or in connection with this **agreement** is not valid if sent by email.]

20. SEVERANCE

20.1 If any provision or part-provision of this **agreement** is or becomes invalid, illegal or unenforceable, it shall be deemed modified to the minimum extent necessary to make it valid, legal and enforceable. If such

modification is not possible, the relevant provision or part-provision shall be deemed deleted. Any modification to or deletion of a provision or part-provision under this clause shall not affect the validity and enforceability of the rest of this **agreement**.

20.2 [If [one party gives notice to the other of the possibility that] any provision or part of a provision of this **agreement** is invalid, illegal or unenforceable, the parties shall negotiate in good faith to amend such provision so that, as amended, it is valid, legal and enforceable and, to the greatest extent possible, achieves the intended commercial result of the original provision.]

21. THIRD PARTY RIGHTS

21.1 [Except as expressly provided in *Clause 21.2* or elsewhere in this **agreement**, this **OR** This] **agreement** is made for the benefit of the parties to it and their successors[and permitted transferees] and is not intended to benefit, or be enforceable by, anyone else.

21.2 [This **agreement** is made for the benefit of [each member of the Seller's Group and] future buyers of the [entire issued share capital **OR** the business and assets] of the Target and the Buyer's undertakings and obligations in this **agreement** shall be enforceable by each of them to the fullest extent permitted by law as if they were a party to this **agreement**.]

21.3 The rights of the parties to terminate, rescind or agree any variation, waiver or settlement under this **agreement** are not subject to the consent of any other person.

22. COUNTERPARTS

22.1 This **agreement** may be executed in any number of counterparts, each of which when executed shall constitute a duplicate original, but all the counterparts shall together constitute the one **agreement**.

22.2 [No counterpart shall be effective until each party has signed and delivered to the other party at least one counterpart.]

22.3 Transmission of [a signed counterpart of this **agreement OR** the signed signature page of a counterpart of this **agreement**] by:

(a) fax; or

(b) email (in PDF, JPEG or other agreed format),

shall take effect as delivery of a signed counterpart of this **agreement**. If either method of delivery is adopted, each party shall, without prejudice to the validity of the **agreement** thus made, provide the other with the original of such counterpart as soon as reasonably possible thereafter.

23. RIGHTS AND REMEDIES

23.1 Except as expressly provided in this **agreement**, the rights and remedies provided under this **agreement** are in addition to, and not exclusive of, any rights or remedies provided by law.

23.2 [Without prejudice to any other rights or remedies that the Seller may have, the Buyer acknowledges and agrees that damages alone would not be an adequate remedy for any breach of the terms of this **agreement** by the Buyer. Accordingly, the Seller [or any member of its Group] shall be entitled to the remedies of injunction, specific performance or other equitable relief for any threatened or actual breach of the terms of this **agreement**.]

24. LANGUAGE

24.1 If this **agreement** is additionally signed in, or is translated into, any language other than [English **OR** SPECIFY LANGUAGE], the [English **OR** SPECIFY LANGUAGE] language version shall prevail.

24.2 Any other document provided in connection with this **agreement** shall be in [LANGUAGE], or there shall be a properly prepared translation into [LANGUAGE] and the [LANGUAGE] translation will prevail in the case of any conflict between them.

25. GOVERNING LAW AND JURISDICTION

25.1 This **agreement** and any dispute or claim [(including non-contractual disputes or claims)] arising out of or in connection with it or its subject matter or formation shall be governed by and construed in accordance with the law of [JURISDICTION].

25.2 Each party irrevocably agrees that the courts of [JURISDICTION] shall have [exclusive **OR** non-exclusive] jurisdiction to settle any dispute or claim [(including non-contractual disputes or claims)] arising out of or in connection with this **agreement** or its subject matter or formation.

This **agreement** has been entered into on the date stated at the beginning of it.

Signed by [NAME OF DIRECTOR] for and	.....
on behalf of [NAME OF **Seller**]	[Director]

Signed by [NAME OF DIRECTOR] for and	.....
on behalf of [NAME OF **Buyer**]	[Director]

Appendix B

Exclusivity agreement: share purchases

by *Practical Law Corporate*[1]

Standard documents | **Maintained** | England, Wales

An **exclusivity agreement** (also known as a lock-out **agreement**) for use in connection with the sale and purchase of the entire issued share capital of a private company incorporated in England and Wales, by a single corporate seller to a corporate buyer.

This **agreement** is dated [DATE]

PARTIES

(1)[FULL COMPANY NAME], incorporated and registered in England and Wales with company number [NUMBER] whose registered office is at [REGISTERED OFFICE ADDRESS] **(Seller)**

(2)[FULL COMPANY NAME], incorporated and registered in England and Wales with company number [NUMBER] whose registered office is at [REGISTERED OFFICE ADDRESS] **(Buyer)**

BACKGROUND

(A) The Buyer and the Seller [have entered into preliminary discussions **OR** intend to enter into preliminary discussions] regarding the Proposed Transaction.

(B) The Seller has agreed to grant the Buyer a period of **exclusivity** in which to evaluate and negotiate the Proposed Transaction, on the terms set out in this **agreement**.

AGREED TERMS

1. INTERPRETATION

1.1 The definitions and rules of interpretation in this clause apply in this **agreement**.

Exclusivity Period: the period commencing on the date of this **agreement** and ending [at [TIME]] on [DATE].

Group: in relation to a company, that company, any subsidiary or any holding company from time to time of that company, and any subsidiary from time to time of a holding company of that company. Each company in a Group is a member of the Group.

Proposed Transaction: the acquisition of the entire issued share capital of the Target by the Buyer.

[1] Practical Law Global "UK Standard Document W-004-7888" (2019) Thomson Reuters < https://uk.practicallaw.thomsonreuters.com/w-004-7888> (accessed 12-12-2019).

Restricted Transaction: each and any of the following:

a. [any investment in the Target [or any other member of its Group];]

b. the disposal (whether by way of sale, offer, transfer or otherwise) of all or any part of, or any interest in, the issued share capital of the Target [or any other member of its Group];

c. the disposal (whether by way of sale, offer, transfer or otherwise) of all, or [any **OR** a material] part of, the business, assets or undertaking of the Target [or any other member of its Group], other than in the ordinary course of trading; or

d. any other disposal, **merger**, business combination or similar transaction involving the Target [or any other member of its Group].

Target: [INSERT NAME OF TARGET], incorporated and registered in England and Wales with company number [NUMBER], whose registered office is at [REGISTERED OFFICE ADDRESS].

Third Party: any person other than the Buyer, a member of the Buyer's Group or any of their respective officers, employees, agents or advisers.

Third Party Negotiations: any discussions or negotiations relating to or otherwise concerning a Restricted Transaction, between a Third Party and any of the Seller, the Target or another member of the Seller's Group (or any of their respective officers, employees, agents or advisers).

1.2 References to clauses are to the clauses of this **agreement**.

1.3 A **person** includes a natural person, corporate or unincorporated body (whether or not having separate legal personality).

1.4 This **agreement** shall be binding on, and enure to the benefit of, the parties to this **agreement** and their respective successors and permitted assigns, and references to any **party** shall include that party's successors and permitted assigns.

1.5 A reference to a **holding company** or a **subsidiary** means a holding company or a subsidiary (as the case may be) as defined in section 1159 of the Companies Act 2006 [and for the purposes only of the membership requirement contained in sections 1159(1)(b) and (c), a company shall be treated as a member of another company even if its shares in that other company are registered in the name of:

(a) another person (or its nominee) by way of security or in connection with the taking of security; or

(b) its nominee].

1.6 Unless expressly provided otherwise in this **agreement**, a reference to **writing** or **written** includes fax and email.

1.7 Any words following the terms **including**, **include**, **in particular**, **for example** or any similar expression shall be construed as illustrative and shall not limit the sense of the words, description, definition, phrase or term preceding those terms.

1.8 Any obligation not to do something includes an obligation not to allow that thing to be done.

2. EXCLUSIVITY UNDERTAKINGS

2.1 In consideration of the Buyer [paying to the Seller the sum of £[1.00], receipt of which is hereby acknowledged and] incurring fees, expenses and other costs in connection with, and committing management time and resources to, its due diligence investigations in relation to the Target and negotiating the Proposed Transaction, the Seller undertakes to the Buyer that for the duration of the **Exclusivity** Period it will not (and will procure that no other member of its Group nor any of their respective officers, employees, agents or advisers will), directly or indirectly:

(a) continue, re-start, enter into, initiate or participate in any Third Party Negotiations;

(b) invite, induce, encourage, solicit or respond to any approach that might lead to Third Party Negotiations;

(c) invite, induce, encourage or solicit any offer or expression of interest from a Third Party in relation to a Restricted Transaction;

(d) enter into any **agreement**, arrangement or understanding (whether or not legally binding) with a Third Party in connection with a Restricted Transaction; [or]

(e) [withdraw from negotiations with the Buyer in relation to the Proposed Transaction; or]

(f) supply, disclose or otherwise make available to a Third Party any information concerning the Target [or any other member of its Group] for the purpose of enabling it to evaluate, or decide whether to make an offer in connection with or otherwise pursue, a Restricted Transaction.

2.2 Upon entering into this **agreement**, the Seller will immediately terminate, or procure the termination of, any Third Party Negotiations that are currently taking place.

2.3 The Seller will [immediately **OR** promptly] notify the Buyer in writing if, at any time during the **Exclusivity** Period, it or any other member of its Group receives an offer (whether written or oral), indication of interest, proposal or enquiry from a Third Party concerning a Restricted Transaction.

3. BUYER'S REMEDIES

3.1 If the Seller breaches any of the undertakings or obligations in *Clause 2.1*[, *Clause 2.2* or *Clause 2.3*] of this **agreement**, it will (without prejudice to any other rights or remedies that the Buyer may have) indemnify the Buyer for an amount equal to all [reasonable] costs, fees, disbursements and expenses (including in each case any applicable VAT) which have been or will be incurred by the Buyer in connection with its investigation, evaluation and negotiation of the Proposed Transaction (including any costs, fees or expenses incurred before

entering into this **agreement**).

3.2 Without prejudice to any other rights or remedies that the Buyer may have, the Seller acknowledges and agrees that damages alone would not be an adequate remedy for any breach of the terms of this **agreement**. Accordingly, the Buyer shall be entitled to the remedies of injunction, specific performance or other equitable relief for any threatened or actual breach of the terms of this **agreement**.

4. ASSIGNMENT

Neither party shall assign, transfer, mortgage, charge, subcontract, declare a trust over or deal in any other manner with any or all of its rights and obligations under this **agreement**.

5. CONFIDENTIALITY AND ANNOUNCEMENTS

5.1 This **agreement** is confidential to the parties and their advisers and is subject to the confidentiality **agreement** already entered into between the Buyer and the Seller dated [DATE] which continues in full force and effect.

5.2 No party shall make, or permit any person to make, any public announcement concerning the existence, subject matter or terms of this **agreement**, the wider transactions contemplated by it, or the relationship between the parties, without the prior written consent of the other party, except as required by law, any governmental or regulatory authority (including, without limitation, any relevant securities exchange), any court or other authority of competent jurisdiction.

6. ENTIRE AGREEMENT

6.1 This **agreement** constitutes the entire **agreement** between the parties and supersedes and extinguishes all previous discussions, correspondence, negotiations, drafts, **agreements**, promises, assurances, warranties, representations and understandings between them, whether written or oral, relating to its subject matter.

6.2 Each party acknowledges and agrees that in entering into this **agreement** it does not rely on, and shall have no remedies in respect of, any statement, representation, assurance or warranty (whether made innocently or negligently) that is not set out in this **agreement**. Each party agrees that it shall have no claim for innocent or negligent misrepresentation [or negligent misstatement] based on any statement in this **agreement**.

7. VARIATION AND WAIVER

7.1 No variation of this **agreement** shall be effective unless it is in writing and signed by the parties (or their authorised representatives).

7.2 No failure or delay by either party to exercise any right or remedy provided under this **agreement** or by law shall constitute a waiver of that or any other right or remedy, nor shall it prevent or restrict the further exercise of that or any other right or remedy. No single or partial exercise of such right or remedy shall prevent or restrict the further exercise of that or any other right or remedy.

8. SEVERANCE

If any provision or part-provision of this **agreement** is or becomes invalid, illegal or unenforceable, it shall be deemed deleted, but that shall not affect the validity and enforceability of the rest of this **agreement**.

9. COSTS

Save as provided in *Clause 3.1*, each party shall pay its own costs and expenses incurred in connection with the Proposed Transaction, including the negotiation, preparation and execution of this **agreement**.

10. THIRD PARTY RIGHTS

10.1 Unless it expressly states otherwise, this **agreement** does not give rise to any rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this **agreement**.

10.2 The rights of the parties to rescind or vary this **agreement** are not subject to the consent of any other person.

11. GOVERNING LAW AND JURISDICTION

11.1 This **agreement** and any dispute or claim (including non-contractual disputes or claims) arising out of or in connection with it or its subject matter or formation shall be governed by and construed in accordance with the law of England and Wales.

11.2 Each party irrevocably agrees that the courts of England and Wales shall have [exclusive **OR** non-exclusive] jurisdiction to settle any dispute or claim (including non-contractual disputes or claims) arising out of or in connection with this **agreement** or its subject matter or formation.

This **agreement** has been entered into on the date stated at the beginning of it.

Signed by [NAME OF DIRECTOR] for and	.....
on behalf of [NAME OF SELLER]	Director

Signed by [NAME OF DIRECTOR] for and	.....
on behalf of [NAME OF BUYER]	Director

Appendix C

Letter of intent (private company acquisitions): Cross-border

by Practical Law Global[1]

Standard documents | **Maintained** | Australia, Brazil, Canada, China, France, Germany, Hong Kong - PRC, India, Indonesia, Italy, Japan, Mexico, Nigeria, Russian Federation, Singapore, **South Africa**, South Korea, Spain, The Netherlands, Turkey, United Arab Emirates, United Kingdom, United States

Standard form letter of intent (also known as heads of terms, term sheet or memorandum of understanding), by which the parties outline their intention to buy and sell all the shares (or equivalent equity interest) in a privately-owned company incorporated and registered outside the UK. This standard document includes legally binding provisions relating to the **exclusivity** of negotiations and costs and assumes that a confidentiality **agreement** has already been entered into. It has been drafted from the perspective of the buyer.

This document has been adapted from *Standard document, Heads of terms: share purchases* to provide a plain English, UK-style jurisdiction neutral starting point for local counsel to adapt in cross-border transactions.

For a form of letter of intent to use in connection with cross-border asset and business acquisitions, see *Standard document, Letter of intent (asset purchases): Cross-border*.

Jurisdiction-specific drafting notes (updated periodically) provide practical information for Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Mexico, The Netherlands, Nigeria, Russian Federation, Singapore, South Africa, South Korea, Spain, Turkey, United Arab Emirates, the UK (England and Wales) and the United States.

[On headed notepaper of Buyer]

[1] Practical Law Global "UK Standard Document 7-101-4187" (2019) Thomson Reuters < https://uk.practicallaw.thomsonreuters.com/7-101-4187> (accessed 12-12-2019).

[NAME[S] AND ADDRESS[ES] OF SELLER[S]]

[DATE]

Dear [SELLER[S]]

Potential acquisition of the [entire issued share capital] of [TARGET COMPANY] (Target)

This letter sets out the principal terms and conditions on and subject to which [FULL NAME OF BUYER] (**Buyer**) is willing to buy all the [issued shares] in the Target [(**Shares**)] from [[FULL NAME[S] OF SELLER[S]] ([each a]**Seller**[, together the **Sellers**]) **OR** the **Sellers** (as defined in *Paragraph 1.2*)], subject to the **agreement** and signature by the parties of a detailed legally binding acquisition **agreement**.

This letter is not exhaustive and is not intended to be legally binding between the Buyer and the Seller except as specifically provided otherwise in this letter.

1. SHARES TO BE PURCHASED

1.1 The Buyer proposes to buy [(either directly or through one of its wholly-owned subsidiaries)] [the legal and beneficial interest in] the Shares free from all claims, liens, equities, charges, encumbrances and adverse rights of any description (**Proposed Transaction**).

1.2 The Shares are owned by the [Sellers **OR** persons set out below (each a **Seller**, together the **Sellers**)] in the following proportions:

Name of Seller	**Number and class of shares**	**Percentage of issued share capital**
[NAME]	[NUMBER] [CLASS] shares of [CURRENCY] [AMOUNT] each	[NUMBER]%
[NAME]	[NUMBER] [CLASS] shares of [CURRENCY] [AMOUNT] each	[NUMBER]%
[NAME]	[NUMBER] [CLASS] shares of [CURRENCY] [AMOUNT] each	[NUMBER]%

1.3 [The Target has the following wholly-owned subsidiaries (**Subsidiaries**):

Name and registered number	**Registered office**

[NAME OF SUBSIDIARY] (Co. No. [NUMBER])	[REGISTERED OFFICE]
[NAME OF SUBSIDIARY] (Co. No. [NUMBER])	[REGISTERED OFFICE]

In this letter, references to the **Target Group** means the Target and each of the Subsidiaries.

OR

The Target has no subsidiaries.]

2. PRICE

2.1 Subject to the completion of satisfactory due diligence [and the price adjustment set out in *Paragraph 2.3*], the Buyer will pay an aggregate price equal to [CURRENCY] [AMOUNT] for the Shares (**Price**).

2.2 [The Price will be paid to the Seller in full and in cash on closing of the Proposed Transaction (**Closing**).

OR

The Price will be satisfied by:

(a) the payment to the Seller of [CURRENCY] [AMOUNT] in cash on closing of the Proposed Transaction (**Closing**); [and]

(b) [the payment to the Seller of [CURRENCY] [AMOUNT] in cash on [each of] [DATE], [DATE] and [DATE]];]

(c) [the allotment and issue to the Seller[s] on Closing of [[NUMBER] **OR** the number of] [CLASS] shares of [CURRENCY] [NOMINAL AMOUNT] each in the capital of the Buyer [having an aggregate value of at least [CURRENCY] [AMOUNT]] (the **Consideration Shares**). [For this purpose, the value of each Consideration Share will be [[a sum equal to the average of the middle market quotations for a[n] [CLASS] share of the Buyer [as shown by [NAME OF LISTING INDEX] of [SECURITIES EXCHANGE] for each of the [NUMBER] working days immediately preceding Closing **OR** [SPECIFY BASIS FOR DETERMINING VALUE OF EACH CONSIDERATION SHARE];]

(d) [the issue to the Seller[s] on Closing of [CURRENCY] [AMOUNT] [floating rate **OR** [NUMBER]%] [guaranteed] [unsecured] loan notes [YEAR] of the Buyer constituted by a loan note instrument in terms to be agreed by the Buyer and the Seller[, including the matters specified in *Paragraph 2.5*].]

OR

The Buyer will pay [CURRENCY] [AMOUNT] of the Price to the Seller[s] in cash on closing of the Proposed

Transaction (**Closing**) and will deposit the remaining [CURRENCY] [AMOUNT] in an escrow account [to be opened in the [joint] name[s] of the Buyer's lawyers [and the Seller[']s['] lawyers] **OR** with a mutually acceptable escrow agent,] where it will be held until [DATE] in order to secure the performance of Seller[']s['] post-Closing obligations under the Share Purchase **Agreement**.

2.3 [The Price will be subject to the following adjustments:

(a) if the [net assets] of the Target [Group] at Closing are less than [CURRENCY] [AMOUNT], the Price will be reduced by an amount equal to the shortfall; or

(b) if the [net assets] of the Target [Group] at Closing are greater than [CURRENCY] [AMOUNT], the Price will be increased by an amount equal to the excess.]

[For this purpose, the [net assets] of the Target [Group] at Closing will be determined by reference to a [consolidated] balance sheet [and profit and loss account] for the Target [Group] for the period from [DATE] to Closing as prepared and agreed by the Buyer and the Seller[s] following Closing (the **Closing Accounts**). The principles governing the preparation and **agreement** of the Closing Accounts and the calculation of the [net assets] will be set out in the Share Purchase **Agreement** in terms to be agreed by the Buyer and the Seller[s], including: [SET OUT MATERIAL TERMS RELATING TO CLOSING ACCOUNTS ADJUSTMENT].]

2.4 [The Consideration Shares will rank *pari passu* in all respects with the existing [CLASS] shares of [CURRENCY] [NOMINAL AMOUNT] each in the capital of the Buyer, including the right to receive all dividends declared, made or paid after Closing (save that they will not rank for any dividend or other distribution declared made, or paid by reference to a record date before Closing).]

2.5 [[IF RELEVANT, SPECIFY MATERIAL TERMS OF LOAN NOTES].]

2.6 [The Price will be paid to the Sellers in [proportion to their respective holdings of the Shares **OR** the following proportions:

Name of Seller	**[Percentage OR Proportion] of Price**
[NAME]	[CURRENCY] [AMOUNT]
[NAME]	[CURRENCY] [AMOUNT]
[NAME]	[CURRENCY] [AMOUNT]

]

3. ASSUMPTIONS

The Buyer has calculated the Price on the basis of [the information contained in the information memorandum relating to the Target dated [DATE] [as provided to the Buyer on [DATE]] **OR** [DETAILS OF INFORMATION PROVIDED TO THE BUYER and based on] the following assumptions:

(a) [SET OUT RELEVANT ASSUMPTIONS].

(b) [SET OUT RELEVANT ASSUMPTIONS].

4. CONDITIONS

The Proposed Transaction is conditional on the following matters:

(a) the Buyer conducting and being satisfied with the results of legal, financial, taxation and commercial due diligence concerning the Target [Group] and its business, assets and liabilities[, including (but not limited to) [LIST SPECIFIC REPORTS AND INVESTIGATIONS REQUIRED] and any other matters the Buyer considers necessary];

(b) the parties agreeing, signing and exchanging a share purchase **agreement** incorporating all the terms of the Proposed Transaction, including (without limitation) the matters set out in *Paragraph 6* (**Share Purchase Agreement**);

(c) approval of the Proposed Transaction by [the board of directors **OR** [OTHER COMPETENT GOVERNING BODY]] [and shareholders] of [the Buyer **OR** [ULTIMATE PARENT OF THE BUYER]][and the Seller[s]];

(d) [the Seller[s] providing the Buyer with management accounts for the Target [Group] in respect of the period to [DATE], and such accounts being [satisfactory to the Buyer **OR** [SPECIFY WHAT BUYER EXPECTS SUCH ACCOUNTS TO SHOW]];]

(e) [any third party, regulatory or tax consents or approvals necessary [or desirable] for the Proposed Transaction being received on terms [reasonably] satisfactory to the Buyer [and the Seller[s]] including, in particular:

(i) [SPECIFY MATERIAL CONSENTS],

and such consents and approvals remaining in full force and effect;]

(f) [the Seller's warranties in the Share Purchase **Agreement** being true and accurate at Closing and the Seller[s] not otherwise being in [material] breach of [its **OR** their] obligations under such **agreement**;]

(g) [there being no material adverse change in the business, operations, assets, position (financial, trading or otherwise), profits or prospects of the Target [Group] [between the date of this letter and Closing];]

(h) [no contract, licence or financial **agreement** that [is material to **OR** affects] the business of the Target

[Group] being terminated or amended [in any materially adverse respect] [between the date of this letter and Closing];]

(i) [each of [NAMES OF KEY EMPLOYEES] entering into new service **agreements** with the Target [for a minimum period of [NUMBER] years from Closing and otherwise] on terms acceptable to the Buyer;]

(j) [the resignation of [NAME OF DIRECTORS/EMPLOYEES] from their positions as [directors] [and] [employees] of the Target [Group] with effect from Closing, without compensation for loss of office or otherwise;]

(k) [the grant to the Target [Group] by [NAME OF AUTHORITY/PERSON] of new licences in respect of [SUBJECT MATTER OF LICENCES], on terms satisfactory to the Buyer;]

(l) [the Buyer having secured financing for the Proposed Transaction;]

(m) the delivery of a legal opinion from [the Seller[']s['] lawyers], in a form satisfactory to the Buyer, confirming (among other things) that the Seller[s] [has **OR** have] the requisite power, authority and capacity to enter into the Share Purchase **Agreement** [and that the Seller[']s['] obligations under the Share Purchase **Agreement** are legal, valid, binding and enforceable];

(n) [any shareholder resolutions required for the allotment and issue of the Consideration Shares being duly passed by the Buyer's shareholders;]

(o) [no government or other person having:

(i) commenced or threatened to commence any proceedings or investigation for the purpose of prohibiting or otherwise challenging or interfering with the Proposed Transaction;

(ii) taken or threatened to take any action as a result or in anticipation of the Proposed Transaction that would be inconsistent in any material respect with any of the warranties in the Share Purchase **Agreement**; or

(iii) enacted or proposed any legislation (including any subordinate legislation) or order or imposed any condition which would prohibit, materially restrict or materially delay the implementation of the Proposed Transaction;]

(p) [the approval of all relevant competition authorities having been obtained and no relevant competition authority having raised any objections; and]

(q) [[DETAILS OF ANY OTHER CONDITIONS].]

5. DUE DILIGENCE

5.1 As soon as reasonably practicable after the signature of this letter, the Buyer will arrange for its advisers to carry out a [detailed] due diligence investigation of the Target [Group], including its legal, accounting, financial, commercial and taxation affairs.

5.2 The Seller will[, so far as is reasonably practicable [(and subject always to the remaining provisions of this *Paragraph 5*)]]:

(a) provide the Buyer's officers, employees, agents and professional advisers with full access to such records, key employees, advisers and operations of the Target [Group] as the Buyer may [reasonably] require to carry out its due diligence investigation;

(b) provide, or make available to the Buyer's officers, employees, agents and professional advisers such information relating to the Target [Group] as the Buyer may [reasonably] require in order to evaluate and assess the Target [Group] and its business, assets and liabilities in connection with the Proposed Transaction; and

(c) respond to all due diligence enquiries raised by or on behalf of the Buyer for the purpose of the Proposed Transaction in a comprehensive, accurate and timely manner.

5.3 [All requests for information or other enquiries made by or on behalf of the Buyer in connection with its due diligence investigation will be made via [the Seller[']s[']] designated representative **OR** [NAME] at [CONTACT DETAILS]].]

5.4 [Except with the prior written consent of the Seller[s], neither the Buyer nor anyone acting on its behalf will contact or communicate directly with any officers, employees, consultants, advisers, landlords, bankers, customers, clients or suppliers of the Target [Group] or disclose to any of them the purpose of the Buyer's due diligence investigations.]

6. SHARE PURCHASE AGREEMENT

6.1 As soon as reasonably practicable following the signature of this letter of intent by the parties to it, the Buyer and the Seller[s] will begin negotiating a Share Purchase **Agreement**, the initial draft of which will be prepared by [the Buyer's lawyers].

6.2 The Share Purchase **Agreement** will include (without limitation) the terms summarised in this *Paragraph 6*, together with such other terms, conditions, warranties, covenants and indemnities as are [customary in **OR** appropriate to] a transaction of the nature of the Proposed Transaction.

6.3 The Seller[s] will provide the Buyer with [customary] warranties [and representations] [appropriate to the Proposed Transaction] relating to the Target [Group] and its business, assets and liabilities, in terms to be agreed by the parties [(**Transaction Warranties**)]. [The Transaction Warranties will address (without limitation) the [Target [Group]'s legal, financial, commercial, accounting and taxation position[, including the following matters:

(a) [DETAILS OF SPECIFIC WARRANTIES]].

6.4 The Seller[s] will provide an indemnity to the Buyer[, on a joint and several basis and] in terms to be agreed

by the parties, in respect of:

(a) the Target [Group]'s tax liabilities[, tax losses and reliefs and the adequacy of its provisions for taxation]; [and]

(b) [[DETAILS OF OTHER SPECIFIC INDEMNITIES REQUIRED]; and]

(c) any other actual or potential liabilities identified during the Buyer's due diligence investigation in respect of which the Buyer requires indemnity cover.

6.5 [The Seller[']s['] liability under the Transaction Warranties will be subject to [customary] limitations [appropriate to the Proposed Transaction], in terms to be agreed by the parties[, including the following:

(a) the Seller[']s['] aggregate liability will be capped at [the Price **OR** [CURRENCY] [AMOUNT]];

(b) the period for notifying any claims under the Transaction Warranties will expire [NUMBER] [months **OR** years] following Closing;

(c) all individual claims under the Transaction Warranties with a value of less than [CURRENCY] [AMOUNT] will be excluded;

(d) the Seller[s] will have no liability under the Transaction Warranties unless the value of the claim (when aggregated with any other warranty claims [having a value in excess of [CURRENCY] [AMOUNT]]) exceeds [CURRENCY] [AMOUNT], in which case the Seller will be liable for the whole amount of the claim and not just the excess; and

(e) [SET OUT DETAILS OF ANY OTHER KEY LIMITATIONS REQUIRED].]

6.6 The Share Purchase **Agreement** will include non-compete[, non-dealing] and non-solicitation undertakings given by the Seller [for itself and on behalf of each of its subsidiaries (but excluding [any members of] the Target [Group])], in a form acceptable to the Buyer[, including (without limitation) undertakings that it will not:

(a) at any time during the period of [NUMBER] years following Closing, compete or have any involvement in a business that competes with the business of the Target [Group];

(b) at any time during the period of [NUMBER] years following Closing, offer employment to, enter into a contract for the services of, or solicit or otherwise attempt to entice away, any employee of the Target [Group];

(c) at any time during the period of [NUMBER] years following Closing [deal with, or] seek the custom of[,] any customers of the Target [Group];[or]

(d) at any time during the period of [NUMBER] years following Closing, [deal with,]solicit or entice away[,] any suppliers of the Target [Group][; or

(e) at any time during the period of [NUMBER] years following Closing, induce or attempt to induce any customer or supplier to cease or refrain from conducting business with, or to reduce the amount of business conducted with, or to vary adversely the terms upon which it conducts business with the Target [Group], or do any other thing which is reasonably likely to have such an effect].

6.7 [The business and activities of the Target [Group] will be carried on in the ordinary course with a view to preserving the goodwill of the Target [Group]. In particular, the Seller[s] will give the Buyer such undertakings regarding the operation of the business and activities of the Target [Group] in the period between signing of the Share Purchase **Agreement** and Closing as the Buyer requires[, including (without limitation) an undertaking to procure that the Target [Group] does not take any of the following actions without the Buyer's written consent:**(a)** [[DETAILS OF KEY MATTERS SUBJECT TO THE BUYER'S CONSENT].]]]

6.8 [[DETAILS OF ANY OTHER KEY ISSUES TO BE ADDRESSED IN SPA].]

7. TIMETABLE AND NEGOTIATIONS

7.1 The Buyer intends to proceed as quickly as possible with the Proposed Transaction. The Buyer and the Seller[s] will negotiate in good faith with a view to [signing the Share Purchase **Agreement** on [or before] [DATE] and] completing the Proposed Transaction no later than [DATE].

7.2 The remaining provisions of this *Paragraph 7* are legally binding.

7.3 The Buyer may terminate negotiations in relation to the Proposed Transaction at any time without giving a reason for doing so and without incurring any liability to the Seller[s] in relation to such termination. For the avoidance of doubt, the provisions of [*Paragraph 8*] (inclusive) of this letter will not be affected by any such termination and they will continue in full force and effect.

7.4 The Buyer and the Seller[s] agree and acknowledge that this letter is not intended to, nor does it create, a legally binding obligation to proceed with the Proposed Transaction and no such obligation will arise unless and until a Share Purchase **Agreement** is agreed, signed and exchanged by the parties.

8. [**EXCLUSIVITY**

8.1 This *Paragraph 8* is legally binding.

8.2 The definitions in this *Paragraph 8.2* apply in this *Paragraph 8*:

[**Exclusivity Period:** the period commencing on the date of this letter and ending [at [TIME]] on [DATE][or, if earlier, the date on which the Buyer notifies the Seller[s] in writing that it is withdrawing from negotiations in relation to the Proposed Transaction].]

[**Group:** in relation to a company (wherever incorporated), that company, any company of which it is a Subsidiary from time to time (its holding company) and any other Subsidiaries from time to time of that company or its holding company. Each company in a Group is a **member of the Group**.]

[**Restricted Activity:** each and any of the following:

a. any investment in the Target [Group];

b. the disposal (whether by way of sale, offer, transfer or otherwise) of all or any part of, or any interest in, the issued share capital of [any member of] the Target [Group]; or

c. the disposal (whether by way of sale, offer, transfer or otherwise) of all, or [any **OR** a material] part of, the business or assets of [any member of] the Target [Group] (other than in the ordinary course of trading).]

[**Subsidiary:** in relation to a company wherever incorporated (a holding company), any company in which the holding company (or persons acting on its or their behalf) directly or indirectly holds or controls either:]

a. a majority of the voting rights exercisable at shareholder meetings of that company; or

b. the right to appoint or remove a majority of its board of directors

and any company which is a Subsidiary of another company is also a Subsidiary of that company's holding company. Unless the context otherwise requires, the application of the definition of Subsidiary to any company at any time shall apply to the company as it is at that time.

[**Third Party:** any person other than the Buyer or a member of the Buyer's Group (or any of their respective officers, employees, agents or advisers).]

[**Third Party Negotiations:** any discussions or negotiations between a Third Party and [any **OR** the] Seller[s] or any other member of the Seller[']s['] Group [or the Target [Group]] (or any of their respective officers, employees, agents or advisers) relating to or otherwise concerning a Restricted Activity.]

8.3 [The Seller[s] agree[s] that for the duration of the **Exclusivity** Period [it **OR** they] will discuss and negotiate the Proposed Transaction with the Buyer on an exclusive basis.]

8.4 [The Seller[s] undertake[s] that for the duration of the **Exclusivity** Period [it **OR** they] will not (and will procure that no other member of [its **OR** their respective] Group nor any of their respective officers, employees, agents or advisers will), directly or indirectly:

(a) continue, enter into, re-start, solicit, initiate or participate in any Third Party Negotiations;

(b) induce, solicit, seek, encourage or respond to any approach that might lead to Third Party Negotiations;

(c) solicit or encourage any offer from a Third Party in relation to a Restricted Activity;

(d) [withdraw from negotiations with the Buyer in relation to the Proposed Transaction;]

(e) enter into any **agreement**, arrangement or understanding (whether or not legally binding) with a Third Party in connection with a Restricted Activity; or

(f) supply, disclose or otherwise make available any information about the Target [Group], its business assets or liabilities to a Third Party for the purpose of evaluating or deciding whether to pursue or make an offer in connection with a Restricted Activity.]

8.5 [On signing this letter, the Seller[s] will immediately terminate or procure the termination of any Third Party Negotiations currently taking place.]

8.6 [The Seller[s] will [immediately **OR** promptly] notify [in writing] the Buyer if, at any time during the **Exclusivity** Period, the Seller[s] (or any member of [its **OR** their respective] Group) or the Target [Group] receives

an offer (whether written or oral), indication of interest, proposal or enquiry from a Third Party concerning a Restricted Activity.]

8.7 [The Seller[s] acknowledge[s] that the Buyer will incur significant costs, fees and expenses in reliance on the undertakings in this *Paragraph 8*. Accordingly, if the Seller[s] [(or any of them)] breach[es] any of those undertakings the Seller[s] will (without prejudice to any other rights or remedies the Buyer may have) indemnify the Buyer for an amount equal to all [reasonable] costs, fees, disbursements and expenses (including in each case any applicable VAT) which have been or will be incurred by the Buyer in connection with its investigation, evaluation and negotiation of the Proposed Transaction (including any costs, fees, disbursements or expenses incurred prior to the signature of this letter).]

8.8 [Without prejudice to any other rights or remedies that the Buyer may have, the Seller[s] acknowledge[s] and agree[s] that damages alone would not be an adequate remedy for any breach of the undertakings in this *Paragraph 8* and the Buyer will be entitled to the remedies of injunction, specific performance or other equitable relief for any threatened or actual breach of such undertakings.]

8.9 [The Sellers' obligations in this *Paragraph 8* are undertaken on a joint and several basis and any reference to the Sellers includes any one or more of them.]]

9. CONFIDENTIALITY

9.1 This *Paragraph 9* is legally binding.

9.2 The content of this letter is confidential to the parties and is subject to the confidentiality **agreement** dated [INSERT DATE] and made between the Buyer and the Seller[s]. That **agreement** is not affected by this letter and continues in full force and effect.

10. COSTS

10.1 This *Paragraph 10* is legally binding.

10.2 [Subject to *Paragraph 8.7* and except **OR** Except] as expressly provided in this letter, the parties shall pay their own costs and expenses incurred in connection with the Proposed Transaction whether or not it proceeds, including (without limitation) all costs and expenses relating to the Buyer's due diligence investigations and the negotiation, preparation and execution of this letter (and any other documents contemplated by it).

11. LANGUAGE

The negotiations in relation to the Proposed Transaction will be conducted in [English **OR** [SPECIFY LANGUAGE]] and all legal **agreements** (including the Share Purchase **Agreement**) will be prepared in [English **OR** [SPECIFY LANGUAGE]].

12. GOVERNING LAW AND JURISDICTION

12.1 This *Paragraph 12* is legally binding.

12.2 This letter and any dispute or claim (including non-contractual disputes or claims) arising out of or in connection with it or its subject matter or formation shall be governed by and construed in accordance with the law of [JURISDICTION].

12.3 The Buyer and the Seller[s] irrevocably agree that the courts of [JURISDICTION] shall have [exclusive **OR** non-exclusive] jurisdiction to settle any dispute or claim (including non-contractual disputes or claims) arising out of or in connection with this letter or its subject matter or formation.

[Yours faithfully,]

.....

[NAME OF [Director]], duly authorised for and on behalf of [NAME OF BUYER]

We confirm our **agreement** to this letter of intent.

Signed:.....

[NAME OF [Director]], duly authorised for and on behalf of [NAME OF SELLER]

Date.....

OR

Signed:.....

By [NAME OF SELLER]

Signed:.....

By [NAME OF SELLER]

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