

## update

10 July 2009

## Friday Facts: Contracts to negotiate in good faith – are they enforceable?

*In the recent case of United Rail Services Limited v Rail Corporation New South Wales [2009] NSWCA 177, the New South Wales Court of Appeal held that a contractual clause which required the parties to negotiate in good faith was valid and enforceable. The decision brings more certainty to an area of law which has been subject to substantial debate and judicial uncertainty.*

United Rail Group Services Ltd (**United**) entered into two contracts with Rail Corporation New South Wales (**Railcorp**) pursuant to which United was to design and build new rolling stock for Railcorp. Both contracts contained Clause 35, in identical terms, which set out a three step process for the resolution of disputes.

Firstly, the dispute was to be referred to senior representatives of the parties, who were required to “meet and undertake genuine and good faith negotiations with a view to resolving the dispute or difference” (clause 35.11(c)). If the dispute was not resolved within 14 days, then the matter was to be “referred to the Australian Dispute Centre for mediation” (clause 35.11(d)). If the dispute remained unresolved after 42 days, then it was to be referred to arbitration (clause 35.12).

A number of disputes arose during the course of the project. United refused to follow the dispute resolution process set out in the contract and argued that the clauses 35.11(c) and (d), regarding mediation and arbitration, were void and unenforceable.

United also argued that the provision regarding arbitration could not operate alone and was therefore void and unenforceable. The parties agreed that clause 35.11(d) was uncertain and unenforceable because the “Australian Dispute Centre” did not exist.

The primary judge found that clause 35.11(c) was valid and enforceable. His Honour also

found that clause 35.12 was severable from the agreed unenforceability of clause 35.11(d), as it was not the intention of the parties that disputes could only be referred to arbitration if the other dispute resolution clauses were valid.

United appealed this decision and the matter came before the New South Wales Court of Appeal. The primary issue for consideration was whether the obligation to undertake genuine and good faith negotiations had sufficient content not to be uncertain.

The Court of Appeal discussed numerous authorities regarding the enforceability of clauses requiring the parties to negotiate in good faith. Some courts have found that these clauses are akin to agreements to agree and are therefore void for uncertainty, whilst others have found that they are enforceable in certain circumstances.

The Court of Appeal however found that a promise to negotiate genuinely and in good faith with a view to resolving disputes is not vague, illusory or uncertain.

In the reasons for decision, Justice Allsop stated that the words “genuine and good faith negotiations” required the parties to negotiate in an honest and genuine manner with a fidelity to the bargain. His Honour acknowledged that it may be difficult to prove that a party had not undertaken an honest and genuine attempt to settle a dispute in some cases, but concluded that

this does not mean there is no real obligation to do so.

Furthermore, as the contract set a limited time for negotiation and provided alternative dispute resolution processes in the event that the negotiations were unsuccessful, it did not matter whether a resolution was reached at the negotiation stage. The obligation to negotiate in good faith therefore was not an agreement to agree.

The decision of *United v Railcorp* has several implications. Primarily, it demonstrates that agreements to negotiate in good faith will be held by the court to be valid and enforceable in some circumstances. This means that parties can now contract to negotiate in good faith with greater certainty. However, a time limit should be placed on negotiations and alternatives should be provided in the event that those negotiations are unsuccessful.

Parties who find themselves subject to an existing obligation to negotiate in good faith should be mindful of their conduct to ensure that they comply with the obligation.

In doing so, each party is not expected to disregard their own interests but should act in accordance with their promise to undertake negotiations in a genuine and honest manner.

## For more information

For more information, please contact:

- Mary Nemeth, Partner on  
03 9321 7810  
mnemeth@rigbycooke.com.au
- Toniel Paton, Lawyer on 03 9321 7863  
tpaton@rigbycooke.com.au

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Level 13, 469 La Trobe Street  
Melbourne Vic 3000  
T 61 3 9321 7888  
F 61 3 9321 7900

[www.rigbycooke.com.au](http://www.rigbycooke.com.au)