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Agreements To Agree Can Be Disagreeable

A recent decision of the Inner House of the Court of Session in the case Scottish Coal Co. Ltd v Danish Forestry Co. Ltd has reinforced the potential for an "agreement to agree" to be ruled unenforceable.

The Facts

The parties entered into an Option Agreement under which Scottish Coal Co. Ltd had the option to purchase the Dalgig Plantation from Danish Forestry Co. Ltd. The Option Agreement provided that if Scottish Coal proceeded to complete its purchase, Danish Forestry would be granted a standard security over the conveyland to secure the coal royalty payments owed by Scottish Coal.

The Option Agreement did not record an agreed form of ranking agreement setting out how that security would rank ahead of other secured creditors of Scottish Coal. Instead, the Option Agreement merely imposed an obligation upon Danish Forestry to enter into a ranking agreement "reasonably to regulate the [ranking] relationship".

Scottish Coal exercised its option. However, the parties and Scottish Coal's other secured creditor, The Royal Bank of Scotland plc, could not agree the terms of a ranking agreement on terms which they considered "reasonable". The completion of the purchase could not take place until this matter was dealt with. Ultimately, Danish Forestry withdrew from the Option Agreement.

Scottish Coal took the case to court, arguing that Danish Forestry was bound to sell.

The Decision

The Judgement acknowledged that, in some cases, an agreement to contemplate a future agreement is not necessarily fatal. However, in these circumstances, the Option did suffer from a lack of certainty.

The word "reasonably" cannot provide an objective criterion against which a court can adjudicate in the context of ranking agreements, since there is no conventional practice. Fundamental and specific to any ranking agreement is what can be agreed as reasonable between the contracting parties, who inevitably have conflicting interests. If the court was to settle the matter, it would essentially be stepping into the negotiating shoes of the contracting parties. To do so is not legitimately within the court's powers.

The interest of the third party security holder (The Royal Bank of Scotland plc) further complicated this situation. No agreement was reached on how the securities would rank or on the maximum sum recoverable by the first ranking security holder. The Royal Bank of Scotland plc was not a party to the Option Agreement and so could not be bound by a judicial decision on what was a reasonable ranking agreement.

The finalisation of the ranking agreement was critical to the completion of the purchase. The parties failed to make certain the terms of the ranking agreement, and they were not capable of being made certain. Accordingly, it was held that the entire Option Agreement was unenforceable.

Comment

The case underlines the inherent dangers in clauses which create an agreement to agree further terms in the future. In a commercial world, there is often pressure to conclude a binding deal and leave details to be agreed later, with the parties "acting reasonably".

If this is necessary, the parties should make sure there are clear, precise and objective criteria embodied in the contract setting out the basis on which a subsequent agreement on details is to be reached.

If this is not done, an "agreement to agree" may not be an agreement at all.

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