June 2022 | Special Edition: Vol. 16

MHM ASIAN Legal Insights

Key Contacts

Kana Manabe
+65-6593-9762 (Singapore)
kana.manabe@mhm-global.com

Chong Chia Chi
+65-6593-9759 (Singapore)
chiachi.chong@mhm-global.com

Colin Trehearne
+81-3-5220-1827 (Japan)
colin.trehearne@mhm-global.com

Contract negotiation and the effect of pre-contractual statements under English law (Part 1)

Introduction

1. In this series of short publications we look, from the dispute resolution perspective, at the different risks arising in the negotiation, operation, alteration, and termination of contracts. The focus is on key matters that may arise in commercial disputes in business-to-business contracts governed by English law. In this publication, we examine several potentially unintended legal effects arising from precontractual statements under English law, and suggest practical tips to bear in mind when negotiating contracts governed by English law. It is worth focusing on English law as it is frequently the governing law used in international business contracts and because English law has a significant influence on numerous common law jurisdictions, making many of the principles discussed herein of broad application. In the next publication we will examine the risk and potential effects of untrue statements (misrepresentations) in precontractual negotiations which is a further important topic deserving of its own bulletin.

A Common Business Situation

2. Imagine that your business team is involved in negotiations for a potentially important deal. It is a high value business to business contract, time is short, and your business team is keen to conclude the deal. There is fierce competition for the contract that is leading various parties, including your business team, to say a variety of (enticing) things designed to win the deal. Your business has sent various emails to the potential contractual counterparty, and you have exchanged drafts of different documents including drafts of the contract. Not every assurance given, or promise made, has found

its way into the draft contract. Further, it is possible that, because time is short, your business team might suggest the parties start some of the works in parallel with the negotiations to finalise the final contractual language and the deal's details.

Do We Even Need to Consider These Pre-Contractual Statements?

3. In English law there is a long-standing rule – called the "parol evidence rule" – that: (1) when parties have recorded their agreement in writing, they intended the written agreement to be a complete contract between them and (2) parol evidence (being any evidence, oral or written, outside of the written agreement itself) may not be admitted to add to, vary, or contradict the written terms of a contract.[1] On this basis one could reasonably question what risks pre-contractual representations and communications can bring in contract. Over time, however, numerous exceptions to the parol evidence rule have developed and today it is best regarded as a rebuttable presumption rather than an iron-clad rule. Further, four of these exceptions are in particular here relevant:

   A) The parol evidence rule does not apply where the written document is not intended to embody the complete agreement of the parties;

   B) The parol evidence rule does not prevent the court from examining the background or "factual matrix" to the agreement for the purposes of determining the aim and subject matter of the contract;

   C) The parole evidence rule does not prevent the court from examining evidence to assist the court in translating a non-English language contract or specific non-English language terms in the contract; and

   D) The parol evidence rule does not stop the formation of collateral contracts.

4. Each exception and some implications for precontractual statements are briefly discussed below.

[1] Jacobs v Batavia & General Plantation Trust [1924] 1 Ch 287

Exception 1: Written Document Not Intended to Embody the Full Agreement

5. The parol evidence rule only applies to prevent variation of the written (contractual) document where the court has concluded that the parties intended that written document to be a complete record of the parties' agreement. Extrinsic evidence (such as communications exchanged between the parties) may be admissible to show whether the parties did (or did not) intend the document to embody their complete agreement.[2] If the court concludes that the parties did not intend the document to contain their full agreement, then the court will look at all the evidence from start to finish in order to see what bargain was actually agreed between the parties. If that evidence shows that terms outside of the written document "*...were agreed and intended to form part of the contract, then the court will have found that the contract consists partly of the terms contained in the document and partly of the terms agreed outside of it.*"[3] In this way precontractual statements could potentially find new life as terms of the contract in ways unintended by (either or both of) the parties.

Exception 2: Determining the Aim and Subject Matter of the Contract

6. As recently stated by the High Court in April 2022[4], while English courts will generally look at "*all the circumstances surrounding the making of the contract and available to the parties*" to determine the background or "factual matrix", the "*relevant factual matrix does not, however, extend to pre-contractual negotations*".[5] Yet, as held by the Court of Appeal, the spectrum of pre-contractual negotiations are able to relied upon to determine the commercial or business object of a contract (albeit not the object of a particular provision).[6]

7. Whilst there is arguably a fine line, as the Court of Appeal recognized, between referring to pre-contractual communications to evidence the "*aim of the transaction*" (which is admissible) and relying on the same communications to show what a particular contractual provision means (which is not admissible), the orthodox position arguably remains that pre-contractual statements are admissible to evidence the contractual aim (and indeed the subject matter[7]) but not the correct interpretation of a particular provision. As touched upon below, however, there may be other ways for a party to get evidence of the negotiations of a particular term before the court.

---

[2] Ibid and J Evans & Sons (Portsmouth) Ltd v Andrea Merzario [1976] 1 WLR 1078
[3] Smith & Anor v Gregory & Anor [2022] EWHC 910 (Ch) (13 April 2022) quoting from Chitty at 15-025
[4] Smith & Anor v Gregory & Anor [2022] EWHC 910 (Ch) (13 April 2022) quoting from Chitty at 15-055
[5] Smith & Anor v Gregory & Anor [2022] EWHC 910 (Ch) (13 April 2022) at paragraphs 34-35 (emphasis added)
[6] Merthyr (South Wales) Ltd v Merthyr Tydfil County Borough Council [2019] EWCA Civ 526 at 52-54
[7] Compagnie Noga d'Importation et d'Exportation SA v Abacha and others [2003] EWCA Civ 1100

Exception 3: An Aid to Translating a non-English Contract or Contract Term

8. In cross-border transactions it is common to see non-English language terms included in a contract, particularly where the contract covers a heavily regulated industry. To take one example we often see, contracts covering pharmaceutical matters in many countries, including Japan, will often contain Japanese language terms transliterated into English in respect of obligations relating to regulations. Nor is it unusual to have a contract in a language other than English but governed by English law. In such circumstances, (and despite the apparent tension with the prohibition on using such statements to interpret specific contractual provisions) precontractual statements may be admissible to assist the court in translating the terms of a document or an entire contract itself.

Exception 4: Collateral Contracts

9. In general terms a collateral contract is one which runs outside the main written contractual agreement between the parties. Such contracts can arise where a negotiating party refuses to enter into the main contractual agreement without receiving from the other party a promise or assurance. For example, in 2011 a car dealership in England promised a potential customer that if he agreed to pre-order a particular model of Porsche, the dealership would ensure that the customer would receive the first such car that the dealership received from the manufacturer. The Court of Appeal found that the claimant customer had ordered the vehicle (using the dealership's normal contractual forms) because of the car dealership's assurance that he would receive the first one. When the dealership sold the first one it received to a different customer, the dealership had breached this collateral contract.[8]

10. As Lord Denning neatly summarized the position nearly 50 years ago "*When a person gives a promise, or an assurance to another, intending that he should act on it by entering into a contract, and he does act on it by entering into the contract, we hold that it is binding*".[9] The assurance or promise, being a separate and independent contract, may give rise to contractual remedies, including damages, if it is breached. Ordinary contractual principles apply to the determination of damages for breach of a collateral contract: they are intended to put a claimant in the position the claimant would have been in if the statement had been true.

[8] Hughes v Pendragon Sabre Limited T/A Porsche Centre Bolton [2016] EWCA Civ 18.
[9] J Evans & Son (Portsmouth) Ltd v Andrea Merzario Ltd [1976] 1 W.L.R. 1078 at paragraph 7

11. In all, a party that wishes to get the pre-contractual negotiations before the court is likely to look for exceptions to the rule, including through the four ways mentioned above.

Practical Tips for Protecting Against Risk & Unintended Consequences

12. We have set out below some practical tips that parties can take to help protect against the risks and unintended consequences arising from precontractual statements, as set out above. As a starting point you may wish to:

A. *Include an Entire Agreement Clause*: the exact protection and effect will depend on the wording of the clause in question, but in general terms an entire agreement clause ("**EAC**") will state that, when the contract in question is executed, it constitutes the entire agreement between the parties and supersedes any prior agreement. In general, an EAC will be effective in protecting against both (i) claims for breach of collateral contract and (ii) claims that a pre-contractual statement should be understood (and adjudged) by the court as a term of the contract. It bears noting, however, that where the parties to an agreement are under time pressure and works may have already begun pending formal agreement, the parties will need to consider the application of the EAC to these works and in particular whether they are deemed to be part of the new contract (which can be relevant should, for example, these works later give rise to a warranty claim). Parties will also need to consider whether these works, carried out before the formal agreement is executed, are to be compensated separately or if they are to be included in the price to be paid as determined in the finalized contract.

B. *Make sure that your commercial team is aware of the risks that can come with pre-contract statements*: in addition to claims in misrepresentation, it is possible that a party may attempt to get pre-contractual statements before the court as part of the relevant background to contractual interpretation. Where they cannot so do directly (because, for example, the contract contains an effective EAC or because English law otherwise forbids it), a counterparty may use another legal doctrine (such as the above-mentioned use of evidence to show the overall commercial purpose of the

agreement) to try to get the pre-contractual statements and communications before the court. In this way, a party might attempt to influence the court's thinking about specific provisions. Your commercial team should be aware that every document and communication they send is potential evidence should a later dispute arise; and

C. *Integrate the pre-contractual statements into the contract, if they are important*: where it is necessary to rely on any background information or pre-contractual statements, make specific reference to them in the contract itself, potentially in the recitals, or in the body of the contract if you wish the representation to become a term of the agreement.

** Mori Hamada & Matsumoto (Singapore) LLP is licensed to operate as a foreign law practice in Singapore. Where advice on Singapore law is required, we will refer the matter to and work with licensed Singapore law practices where necessary.*

Contact Us
Public Relations
mhm_info@mhm-global.com
+81-3-6212-8330
www.mhmjapan.com