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# 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 Trehearn  
☎ +81-3-5220-1827 (Japan)  
✉ colin.trehearn@mhm-global.com

## Contract negotiation and the effect of pre-contractual statements under English law (Part 2)

### Misrepresentation – Practical Tips for Protecting Against Risk & Preserving Potential Claims

#### 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 Part 1 we examined several potentially unintended legal effects arising from precontractual statements under English law and the parol evidence rule, and suggested practical tips to bear in mind during negotiations. In this publication we examine the risks and potential effects of untrue statements (misrepresentations) in precontractual negotiations. Although the discussion herein focuses on English law, many of the principles discussed have broad application in common law jurisdictions such as Australia, Canada and Singapore.

#### 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 and various parties, including your business team, are saying a variety of (enticing) things designed to win

the deal. Your business has exchanged with the counterparty various emails, meetings have been held, and you have exchanged drafts of different documents including the contract. Not every assurance given, or promise made, has found its way into the draft contract. This article assumes that the parties are speaking and negotiating in good faith: fraudulent misrepresentation, with its intention to deceive, is not considered here except where specifically noted.

## What can Statements made in Negotiations Become?

3. Statements made in the course of contractual negotiations have three main fates, they might become:
  - a. **mere puffs** being mere sales talk, often vague and non-specific or exaggeration beyond serious consideration, without legal effect;
  - b. **representations** as to matters of fact or a party's present intention which are not included in the contractual agreement; or
  - c. **terms** forming part of the ultimate contractual agreement which are binding on the contractual parties.

## What is a Misrepresentation?

4. At its most basic level, a misrepresentation is a false representation (of fact or law) made in the course of negotiations. The misrepresentation can be actually stated or written, or it can be implied by other words or by a party's conduct.
5. Silence, on the other hand, usually does not constitute a misrepresentation as there is normally not a duty under English law to disclose all facts which might affect the other party's decision-making. However, silence too can amount to a misrepresentation, including when:
  - a. a half-truth is said, with the speaker silent as to other relevant matters, which silence makes the statement a misrepresentation. To take an exaggerated example, if a researcher told a company that "this experimental drug completely stops the growth of cancer" but failed to tell the company that the drug stops the growth of cancer because the drug is fatal to all patients, failing to mention this makes the first statement misleading; and
  - b. certain categories of relationships involve duties of utmost good faith or fiduciary duties. For example, there is a duty to disclose material matters when parties are negotiating to form a partnership: failure to disclose here might be a misrepresentation.

6. In general terms, a misrepresentation must induce the other party to enter into the contract and consequently to suffer loss. The alleged misrepresentation needs to be capable of affecting the judgment of a reasonable person but the extent to which it needs to affect their judgment is not fully clear. While some courts have held that the misrepresentation does not need to be the *only* thing that causes the receiving party to enter into the contract, other courts have held that the misrepresentation needs to have played a "*real and substantial*" role in causing the party to contract.

## What Remedies are Available?

7. Where a contract has been concluded with one party (unknowingly) relying on one or more misrepresentations, there are generally two remedies available to the court:
  - a. **Rescission:** here the innocent party may ask the court to, in effect, undo (or "rescind") the contract. If a bad deal was concluded that would lose money even if properly performed, this can be advantageous in unwinding the transaction and getting one's money back; and
  - b. **Damages:** in the case of negligent and innocent misrepresentations, the court may decline to order rescission and instead may declare that (1) the contract nevertheless survives the misrepresentation and (2) damages are due instead of rescission.

## Practical Tips for Protecting Against Risk & Preserving Potential Claims

8. First, consider who the counterparty is. Where the counterparty is substantially less knowledgeable about the business area or matters relating to your representations, increased caution in what your employees say is appropriate. On the other hand, in circumstances where each party is sophisticated and experienced, a claim for misrepresentation may be harder to bring and easier to defend.
9. Second, and particularly for larger potential transactions, it is desirable to carefully verify the information to be provided in negotiations to ensure that it is truthful and not likely to mislead. If you discover that truthful information provided before contracting has later become untrue due to a change in circumstances, ensure that you update the counterparty.
10. Third, consider what is being negotiated. If you are negotiating a partnership, extra caution is appropriate.
11. Fourth, make a record of what has been said by each side in negotiations. Depending on the scale of the deal, it may be sensible to exchange and agree meeting minutes. In

general, such documents recording what was said will be more powerful evidence than later recollections by negotiators.

12. Fifth, one should include an Entire Agreement Clause in the contract in question. The details will vary with the clause's wording but in general terms it will state that, when the contract is executed, it constitutes the entire agreement between the parties. It ordinarily includes wording that states that either no representations have been made, or where made, no reliance was placed on these representations. When parties have agreed to a certain state of affairs (i.e. that no reliance was placed on representations not in the contract) they may be later prevented from arguing that they did in fact place reliance on representations outside the contract.
13. Sixth, a party may also try to protect itself (subject to certain potential statutory restrictions) by excluding liability for misrepresentation that would otherwise arise from representations made in negotiation. On this:
  - a. exclusion clauses are generally interpreted by courts against the party trying to rely on them, so it is important to be clear; and
  - b. a term which excludes liability for fraudulent misrepresentation will not be effective for public policy reasons. To avoid the risk of a court finding that the whole clause is of no effect the clause should state that liability for fraud is not excluded.
14. Seventh, if you discover a misrepresentation:
  - a. Seek legal advice immediately. If you delay in determining what to do you may lose your ability to claim rescission;
  - b. Do not act in a way inconsistent with a decision later to bring the contract to an end – this may prevent a claim for rescission; and
  - c. Do not take steps that would make it impossible to restore both parties to their original positions. For example, if you received goods under a contract, do not sell them to a third party.

*\* 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