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United Kingdom: Entire Agreement? Admissibility Of Pre-Contract Negotiations

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The recent case of *Chartbrook and Another v Persimmon Homes Ltd and Others [2009]* saw the House of Lords reaffirming the long-established position that under English law, anything said or done in the course of negotiating a contract is inadmissible as evidence of what the contract was intended to mean.

This is reflected in the boilerplate "entire agreement" clause present in most commercial contracts, an example of which is below.

"This Agreement represents the entire agreement between the parties and supersedes all prior agreements or representations relating to the subject matter of this Agreement.

The parties acknowledge that in entering into this agreement, they do not rely on any statement or representation made by the other which is not expressly set out in this Agreement."

The law developed in this way in order to promote certainty and reduce disputes over interpretation, particularly as the assignment of contracts became more common. The remedies of rectification and estoppel may be invoked where necessary, since in such actions pre-contract negotiations are admissible on an equitable basis. The Chartbrook decision is therefore surprising because although it on the one hand it affirms the exclusionary rule established in *Prenn v Simmonds [1971]*, the Lords stepped in and effectively rewrote a "commercially absurd" contract – a remedy generally only available in rectification.

The brief facts of the case were that Persimmon, a developer, and Chartbrook, a landowner, signed a Development Agreement in October 2001. Once the development was complete, a dispute arose between them as to the calculation of an "additional residential payment" ("ARP") payable by Persimmon to Chartbrook. The ARP and how to calculate it was defined in the Development Agreement but Persimmon argued it owed Chartbrook £897,051 while Chartbrook made it £4,484,862 and issued proceedings. The disparity between these two figures arose from the ARP being at best not clearly defined, although the fact it was defined at all proved critical. The defined phrases begin with capitals -

"Additional Residential Payment means 23.4% of the price achieved for each Residential Unit in excess of the Minimum Guaranteed Residential Unit Value less the Costs and Incentives"

Chartbrook argued that it was entitled to 23.4% of the price achieved for each Residential Unit in excess of an unspecified but by their calculations minimum guaranteed amount – the £4 million figure they claimed. Persimmon's interpretation was that the ARP was only payable if 23.4% of the net proceeds of sale amounted to more than the Guaranteed Residential Unit Value (£900,000) so the ARP was contingent on that. While the problem was syntactical, reference in the definition of ARP to four other defined terms, themselves not clear, muddied the waters further.

In their defence, Persimmon stated that if it were unsuccessful on construction, it would seek rectification of the Development Agreement on the basis of common or unilateral mistake, to reflect the underlying commercial intentions between the parties. At first instance, Persimmon lost both their construction and rectification arguments, but appealed on both issues in December 2007.

Persimmon lost on appeal, with one dissenting voice. Lord Justice Laurence Collins stated that the case presented a syntactical analysis at odds with business common sense, and that Persimmon's interpretation of the APR was correct.

When the case reached the Lords in July 2009, all five of their Lordships found for Persimmon.

What is interesting here is that throughout the proceedings, virtually all of the correspondence used in pre-contract negotiations was made available to the Court, adduced by Persimmon, hoping to prove that a set formula had been agreed upon for the ARP entitling Chartbrook to it only on a contingent basis. This in itself is unusual since the real issue was one of construction of the contract. Persimmon argued that since particular meanings of certain words and phrases within the contract had not been defined within it, extraneous evidence was therefore necessary to construe their true meanings, as the parties had used their own "private dictionary".

The Court of Appeal had held that the "private dictionary" inroad into the usual exclusion of pre-contractual negotiations was permissible in this instance. It was however at some pains to stress that this "private dictionary" inroad would not be available in any such dispute where the word or phrase was expressly defined in the contract. Persimmon lost in seeking rectification.

The case on which the Court of Appeal relied was very recent – *Proforce Recruit Ltd v The Rugby Group Ltd [2006].* In his judgment in that case, LJ Arden had stated

"...the parties have used a very unusual combination of words...these are undefined and they are not introduced or accompanied by any words of explanation. In those circumstances it is in my judgment reasonably arguable that on their true interpretation those words bear the meaning that the parties in common gave them in their communications leading up to the signing of the contract. In admitting evidence as to those communications, the court would be hearing that evidence not with a view for taking the parties' subjective intent into account for the purposes of interpretation but for the purpose of identifying the meaning that the parties in effect incorporated into their agreement..."

The Lords took a rather different view in *Chartbrook v Persimmon*. Lord Hoffman said

"There is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant."

Yet rectification was not granted to Persimmon by the House of Lords. Persimmon ultimately won their case on construction. At the same time, it was expressly held that there were no reasons to depart from the long-standing rule in *Prenn v Simmons.*

Lord Hoffmann may have had an earlier case of his in mind, namely *Investors Compensation Scheme v West Bromwich Building Society [1998].* In his 1998 judgment, Lord Hoffmann had defined interpretation of a contract as

"...the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties...at the time of the contract."

Lord Hoffmann went on to note that in *Prenn v Simmonds*, Lord Wilberforce had famously referred to such background knowledge as the "matrix of fact", stating that

"...this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification."

Eleven years later, in the Persimmon case, Lord Hoffmann reiterated that pre-contractual negotiations were not admissible in a contractual dispute, but only in an action for rectification.

Had Persimmon not included an action for rectification, one wonders if their case could have made it to the Lords. It is interesting to note that their action for rectification failed at every attempt, although the pre-contractual negotiations were thereby admissible and the court provided an equitable remedy in rewriting the parts of the contract that made no commercial sense. It appears that the pre-contractual negotiations formed part of the "matrix of fact", thus allowing them to be used in determining a construction dispute.

The Lords denied rectification to Persimmon on the grounds that rectification would only have been available had there been a mistake in reducing a prior consensus to writing. Since there was no consensus between the parties, the agreement should have been interpreted in the manner of a reasonable observer, and not what either one or even both the parties believed it to be.

Nonetheless, future difficulty will lie in establishing where background facts end and pre-contractual negotiations begin. As ever, parties to a contract would be well advised to stress-test their contracts prior to inception and to use plain English wherever possible.

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