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IN A BIND - FAILURE TO USE THE WORDS "SUBJECT TO CONTRACT" IN A PROPOSED SETTLEMENT PROVES COSTLY

LITIGATION AND DISPUTE RESOLUTION

In a recent case, *Newbury v Sun Microsystems* [2013] EWHC 2180 (QB), the High Court has held that a letter from the defendant offering to settle a dispute for a specific sum, and a letter of acceptance from the claimant, amounted to a binding contract – despite the fact that the terms of the settlement were not recorded in a formal agreement. The judge rejected the defendant's argument that its offer was "in principle" only and held that, if this was what the defendant intended, its offer letter should have included the words "subject to contract".

The case serves as a reminder that, when negotiating the terms of any contract (not just settlement agreements), parties should be clear whether an offer is intended to be capable of acceptance or whether it is only intended to be a starting point for negotiations. In the former case, the offer should contain all of the terms on which a party is prepared to contract. In the latter case, it should be made clear that further matters need to be agreed before a binding contract will be formed. Applying the label "subject to contract" is often a useful shorthand method of achieving this.

"SUBJECT TO CONTRACT" – OVERVIEW OF THE KEY PRINCIPLES

- A binding contract will not be formed unless the parties intend to create legal relations. This is an objective test: it depends not on the subjective state of mind of the parties, but on what was communicated between them.
- The use of the phrase "subject to contract" in commercial negotiations creates a strong presumption that the parties do not want to be bound.
- Where a "subject to contract" qualification is introduced into negotiations it can only cease to apply to the negotiations if the parties expressly, or by necessary implication, agree that it should no longer apply.

BACKGROUND FACTS IN BRIEF

The claimant, Mr Newbury, brought a claim for unpaid commission against the defendant, Sun Microsystems (Sun). Shortly before trial was to begin, Sun wrote to Mr Newbury's solicitors offering to settle the entire proceedings by paying Mr Newbury, within 14 days of acceptance of the offer, £601,464.98 inclusive of interest plus £180,000 in relation to his legal costs. The letter also provided that the settlement was to be "recorded in a suitably worded agreement".

Mr Newbury's solicitors accepted the offer in a letter that same day, and stated that they would forward a draft agreement for approval. A dispute subsequently arose as to the terms in which the settlement should be recorded. Mr Newbury's solicitors applied to the court for a declaration that the parties had already reached a binding contract following Sun's offer letter and their letter in reply. Sun said that its letter had been "in principle" only and contended that, in determining whether a binding agreement had been formed through the exchange of letters, the court should look at the conduct of the parties after that date, which showed that the parties were still negotiating and that they had not reached a binding contract.

THE DECISION

Lewis J granted the declaration sought. He held that, viewed objectively, Sun's letter and Mr Newbury's solicitors' reply gave rise to a binding legal agreement between the parties. This was because:

i. Sun's letter was expressed to be an offer to settle and it set out the terms of that offer.

ii. The offer was only open for 14 days and, if it was accepted, payment would be made within 14 days.

iii. Lewis J held that the words "such settlement to be recorded in a suitably worded agreement" were not a reference to terms still to be negotiated. Read objectively, the letter offered to settle on certain terms and, if accepted, those terms would be "recorded": that is they would be committed to writing as an authentic record of what had already been agreed. Execution of that written agreement was not a condition of the creation of a binding agreement.

iv. The letter had not been expressed to be "subject to contract". Had those words been used, it would have been clear that the terms would not be binding until a formal contract had been agreed.

v. It was not relevant that, after the exchange of letters, the parties carried on negotiating the terms of the formal agreement. Where a contract is said to be contained in documents, conduct occurring after the date of the documents will not be a legitimate aid in determining whether those documents were intended to give rise to a binding contract.

SUBSTANCE NOT FORM

As explained above, using the phrase "subject to contract" may be a convenient shorthand method of demonstrating that a party does not yet intend to create legal relations. However, it should be remembered that the court will look at the substance, and not the form, of a communication and the application of a particular label may not be decisive. This was demonstrated by the case of *Jirehouse Capital & Others v Beller & Another* [2009] EWHC 2538 (Ch) where the court found that a contract had been formed despite the fact that the parties' emails were marked "subject to contract terms". In finding that a binding contract had been concluded, the judge commented:

"The old observation that solicitors' typewriters had two extra keys marked "subject to contract" and "without prejudice" (suitably adapted to the modern world) is not without a modicum of truth."

CONTACT DETAILS

If you would like to know more about this case, or any of the issues raised in it, please contact:

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