

## Insights

# MARKING YOUR LETTER “SUBJECT TO CONTRACT”: WHAT DOES THE LABEL MEAN? RECENT ENGLISH COURT OF APPEAL JUDGMENT

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It is not uncommon to start a correspondence with a “subject to contract” label. But what does this mean? What is its legal effect?

The recent English Court of Appeal judgment in [Joanne Properties Ltd v Moneything Capital Ltd & Anor](#) [2020] EWCA Civ 1541 (19 November 2020) provides a succinct explanation of the legal principles behind the “subject to contract” label and its effects to prevent the formation of a binding contract before formal documentation is entered into.

## Brief facts

The Appellant (as a borrower) and the Respondents (as lenders) entered into a loan agreement. The loan was secured by a legal charge over the Appellant’s property. As a result of the Appellant falling into arrears under the charge, the Respondents appointed a receiver over the charged property.

The Appellant challenged the appointment of the receiver on the ground that both the loan agreement and the charge had been procured by undue influence. Subsequently, the Appellant (a) sought to set aside the loan agreement and the charge, and (b) applied for an injunction against the receiver to prevent any realisation of the security.

The Appellant and the Respondents made the following compromises regarding the Appellant’s injunction application, which were embodied in a formal written and signed agreement:

- the sum of £140,000 was to be ring-fenced, representing “sums that may be determined to be payable to [either party] subject to the terms on which the claim is resolved”; and
- any balance was to be ring-fenced for the resolution of a dispute relating to another charge over the property in favour of a third party.

At a later date, the parties exchanged communications regarding the sharing of the sum of £140,000. It was these communications that were the subject of the Court of Appeal judgment.

## Issue

The issue was whether the parties had entered into a further binding contract of compromise regarding the allocation of the sum of £140,000, by way of the written communications passing between their respective solicitors.

## Legal principles

The English Court of Appeal confirmed some relevant legal principles as follows:

- The question of whether the parties intend to enter into a legally binding contract, of course, is to be determined objectively.
- The use of the “subject to contract” label in negotiations means that (a) neither party intends to be bound either in law or in equity unless and until a formal contract is made, and (b) each party reserves the right to withdraw until such time as a binding contract is made. In other words, the parties are not bound by what has taken place in conversations or discussions until a formal and binding contract is executed.
- Once negotiations begin under the “subject to contract” label, in the ordinary way that condition will be carried through and apply to all the way through the negotiations.
- Parties may free themselves from the qualification of “subject to contract” only if (a) they both expressly agree that it should be expunged, or (b) if such an agreement can be implied from their dealings and exchanges.

The English Court of Appeal distinguished between (a) negotiations “subject to contract”, where the parties do not reach a binding agreement and (b) an incomplete agreement, where the parties intend to enter into a legally binding agreement but some of the terms are left to be agreed later. In this case, the Court found that the dealings between the parties were a negotiation “subject to contract”, but which did not result in any form of binding agreement.

## Application to the facts of the case

The English Court of Appeal rejected the argument that the parties had entered into a binding contract of compromise contained in written communication passing between their respective solicitors.

The Court found that there was no **express** agreement to expunge the “subject to contract” qualification.

Further, the Court also found that there was no **implied** agreement to expunge the “subject to contract” qualification. The Court relied on the following reasons:

- Communications alleged by the Appellant as an offer and acceptance each bore the “subject to contract” or similar labels.
- The Respondents’ solicitors stated in a letter that, unless a draft consent order was agreed by a certain date, the Respondents would apply to the court for an order in those terms. It was a plain contemplation between the parties that a consent order would be required to embody the compromise, just as a consent order had been used in the earlier settlement agreement regarding the Appellant’s injunction application. Such consent order was an equivalence to a formal contract.
- Further, there was no performance of the putative contract. All that had happened was that correspondence had been exchanged.

As a result, the English Court of Appeal overturned the first instance decision, and held that no binding compromise agreement had been reached between the parties regarding the sharing of the sum of £140,000.

## Conclusion

“Subject to contract” is a commonly used phrase in legal parlance. It commonly is used when seeking to reach a settlement or compromise, and also in negotiating terms of a transactional agreement.

In the course of overturning the first instance decision, the English Court of Appeal criticised the court below and said that it had “*seriously undervalued the force of the ‘subject to contract’ label on the legal effect of the negotiation*”. This serves as a reminder to practitioners that if communications between parties are labelled with “subject to contract”, this will prevent the parties being bound by negotiations prior to the execution of a formal contract.

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