NEGOTIATIONS: LIABILITY FOR A 'CHANGE OF HEART'

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Abstract

Often at an advanced stage of negotiation, a party reneges on its earlier assurance that it will enter into a contract with the other party. This may happen with the intention of manipulating the other party to agree to additional terms or because the project has become unviable for the concerned party. This article compares the adoption of doctrine of estoppel to the negotiation stage in two common law jurisdictions of England and Australia. In doing so, the article argues that a liability should be imposed on a party making assurances, during negotiation to the effect that a contract will eventuate between the parties, to promote ethical and cooperative negotiation behaviour. There is a growing agreement that cooperative negotiation strategies (win-win) rather than competitive negotiation strategies (win-lose) are more effective modes of dispute resolution. The article further suggests the adoption of the civil law doctrine of "culpa in contrahedo" which imposes a positive obligation of fair dealing during negotiations rather than invocation of a penalty only when a detriment has been caused to the other party as under the doctrine of estoppel.

Introduction

While commenting on the negotiation style of Apple's founder Steve Jobs, a Sony executive said:

"In classic Steve fashion, he would agree to something, but it would never happen…He would set you up and then pull it off the table."[1]

Though Sony and Jobs eventually entered into a contract, the negotiations took much time and almost broke down at one point. The joint gains for both the parties were reduced as well[2]. The aggressive negotiation technique was risk intensive, as Sony may have walked away

[1] WALTER ISAACSON, STEVE JOBS 401 (2011).
[2] WILLIAM BABER & CHAVI FLETCHER-CHEN, PRATCIAL BUSINESS 108 (2015).

from the deal if a similar technology was available from another party[3]. This paper argues that constructive negotiation behaviour is promoted when a liability is imposed on a party for withdrawing from negotiations, when it has induced the other party to act to its detriment, by making representations that a contract will eventuate between them. In doing so, the paper examines the applicability of the doctrine of estoppel to negotiations in common law jurisdictions of England and Australia, the effect of the doctrine of estoppel on negotiation behaviour and possible regulatory recommendations.

Application of Estoppel to Negotiations

Common law recognizes various kinds of estoppel. The case of *McIlkenny v. Chief Constable of the West Midlands*[4] explains that these different kinds of estoppel "[..]are all under one roof. Someone is stopped from saying something or other, or doing something or other, or contesting something or other".[5] This paper is concerned with the variety of estoppel that applies to negotiations, when the plaintiff has acted on the representations of the defendant that a contract will eventuate between them, notwithstanding that the negotiation is 'subject to contract'. Hence, the following discussion is limited to application of estoppel to the representations of promises or statements of intention rather than representations of facts.

As a rule, English law does not recognize any liability arising from the negotiations at the pre-contractual stage. The underlying principle is that a party undertaking any expenditure at the negotiation stage, subjects itself to the risk that contract may not be executed.[6] In the case of *Walford v. Miles*[7], it was stated that the concept of good faith negotiations is antithetical to the adversarial relationship shared between negotiating parties. Hence, even if a negotiating party has caused the other party to expect that a contract will be concluded and is aware of the latter party's reliance on such expectation, it is still ''[…] entitled, if it thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms.''[8]

[3] Ibid.
[4] McIlkenny v. Chief Constable of the West Midlands [1980] Q.B. 283.
[5] Ibid.
[6] John Cartwright, *Protecting Legitimate Expectations and Estoppel in English Law,* 10 E.J.C.L. 1, 7 (2006).
[7] [1992] 2 A.C. 128.
[8] Ibid, para 138.

The above-mentioned characterisation of negotiation has influenced the enforceability of promissory estoppel in English law. Promissory estoppel stops a party from going back on its promise, when it has induced the other party to rely on it to its detriment. [9] Promissory estoppel, however, cannot be used as a 'sword' to give rise to a cause of action for the enforcement of a promise lacking any consideration.[10] Its use is limited to be a 'shield' where the promisor is estopped from claiming enforcement of its strict legal rights when it has made a representation by words or conduct to suspend such rights.[11]

It is interesting to note that English courts recognize proprietary estoppel as a 'sword'. Under proprietary estoppel, a promisor can be sued for withdrawing its representation to the effect that the promisee has or will have an interest in promisor's land and the promisee relies on such representation.[12] Proprietary estoppel has been applied to property beyond land law. [13] A recent example of an application of proprietary estoppel to commercial negotiations would be *Yeoman's Row Management Ltd. v. Cobbe*[14], the appellant entered into negotiations with the respondent for the development of a property. The parties reached a preliminary agreement that the respondent will secure planning approval for the development of the appellant's property. The parties had intended to enter into a legally binding contract at a later date culling out the specifics. The appellant decided not to proceed with contract, however encouraged the respondent to make efforts to obtain the planning approval. The respondent relied on the conduct of the appellant and incurred considerable expenditure in securing the planning approval. The respondent initiated legal proceedings and based its claim, inter alia, on proprietary estoppel. The House of Lords rejected the claim and held that though the conduct of the appellant was unconscionable, the reliance of the respondent on the representations made by appellant was not reasonable as the respondent knew there was no legally binding contract.

The discussion above shows that English law adopts a narrow position with respect to pre-contractual liability arising from estoppel, especially when the negotiations are subject to a contract. On the other hand, Australia, another common law jurisdiction adopts a broader

[9] Supra Note 6, at 4.
[10] Combe v. Combe [1951] 2 K.B. 215.
[11] HUGH BEALE, CHITTY ON CONTRACTS PARAS 3-085 to 3-105 (29th ed. 2004); Crabb v. Arun District Council [1976] Ch. 179.
[12] Pascoe v. Turner [1979] 1 W.L.R. 431.
[13] Western Fish Products Ltd v. Penwith DC [1981] 2 All E.R. 204 at 218.
[14] [2008] U.K.H.L. 55.

approach towards enforcement of estoppel to pre-contractual negotiations.[15] The case of *Waltons Stores (Interstate) Ltd. v. Maher*[16] concerned negotiations relating to a grant of lease. The contract had not been concluded, but the prospective tenant encouraged the landowner to develop the property according to the apparent agreement between the parties as to the terms. The High Court of Australia held that it would be unconscionable for the prospective tenant to retract from his promise to conclude the contract under the principle of promissory estoppel and imposed damages. However, the court clarified that unconscionable or the inequitable conduct of the defendant is *sine qua non* to invoke promissory estoppel. [17] Their honours also linked promissory estoppel and proprietary estoppel stating that they both are "mere facets of the same general principle".[18] Unlike the English law, Australian courts have held that negotiations being 'subject to the contract' is one of the factors and not the sole factor in determining the reasonableness of the reliance placed on the representations [19] albeit there have been some judgements[20] which have adopted a narrower view like the English courts.

In Australian courts, the imposition of precontractual liability is determined by whether a reasonable person will deduce the same meaning as the plaintiff from the representation. For instance, in the recent case of *Crown Mebourne Ltd. v. Cosmopolitan Hotel (Vic) Pty Ltd.* [21], it was argued that the statement of landlord that the tenant will be "looked after at renewal time" gave rise to a claim of estoppel that the lease will be renewed on the same terms of the original lease. The majority of the court rejected the claim and held that the reliance placed on the statement was unreasonable. Though the Court of Appeal opined that statement may give rise to a limited assumption that the landlord may renew the lease, however the terms may be different.

Two views emerge from the above discussion that may influence negotiation behaviour. The English law stipulates that the plaintiff's reliance on representations made during 'subject to contract' negotiations is unreasonable and misplaced as parties know that there is no intention to be legally bound. While Australian law purports that the plaintiff may be able to

[15] Supra Note 8, at para 3-106; Allison Silink, *Equitable Estoppel in 'Subject Contract' Negotiations*, 5 J. EQUITY 252 (2011).
[16] (1988) 164 C.L.R. 387.
[17] Ibid at para 406.
[18] Ibid at para 403.
[19] EK Nominees Pty Ltd v. Woolworths Ltd. [2006] N.S.W.S.C. 1172.
[20] Franklins Ltd v. Metcash Trading Pty Ltd. [2009] N.S.W.C.A. 407.
[21] [2016] H.C.A. 26.

claim estoppel in some cases where the defendant has encouraged the plaintiff to place detrimental reliance on its representations indicating that a contract will eventuate between the parties. As held by White J., under the Australian position, "the fact that the parties have not entered a contractual relationship provides the occasion for considering the doctrine of estoppel. It is not the end of the inquiry."[22]

Influence on the Negotiation Behaviour

In the previous section, the cases discussed pertained to situations where the promisee relied on the assurances of the promisor that a deal has been secured, although the formal contract is yet to be signed. However, the promisor later reneges on the assurance or seeks to renegotiate the terms of the deal with a view to manipulate the promisee. This section discusses the reasons for a party to act on an assurance when a contract is yet to be signed, the tactical approach behind abandoning such assurance by the promisor and the impact of the law of estoppel on such tactics.

It is often the case that the parties have agreed upon the nature of their obligations in a commercial transaction, but have not precisely defined the terms of the transaction and have not executed a formal written contract. Professor Alan Schwartz and Robert Scott explain that parties enter into such "preliminary agreements" because of the complex nature of the potential project that is being undertaken. The party may invest in such a project for early realization of returns if the project results in profit. [23] For example, earlier the government approvals are obtained for development of a property, the sooner profits can be realized from the developed property. Additionally, an early investment in learning market conditions may cast a light on what will make the project profitable [24]. The parties may agree to manufacture a product, but the product specifications may be defined after learning what makes the product sellable. Hence, it may be necessary to perform the preliminary agreement to describe the project tangibly in the contract [25].

A party may abandon its assurance to pursue a binding contract if it is seeking to renegotiate the terms. The negotiator may be employing the "late hit" tactic to introduce

[22] Supra Note 16, at para 259.
[23] Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661, 703 (2007).
[24] Ibid.
[25] Ibid.

additional terms to its favour at an advanced stage of negotiaton. The other negotiator may be cave into agreeing to such terms as she has invested considerable amount of resources, time and efforts. [26] The parties sometimes have a rough agreement regarding their respective contribution but may leave the specifics for further negotiations when a formal contract is being formulated. At this stage, if a negotiator threatens a walk-out or throws a tantrum, it is attempting to employ a "hardball tactic" to induce the other negotiator to yield[27]. Hardball tactics can be defined as those tactics which manipulate the other party to do a thing which they may otherwise not do.[28] Deliberate deception is a trick often employed in hard ball negotiations[29]. In the *Yeoman's Row Management Ltd. v. Cobbe*[30]case, the defendant did not intend to enter into a binding contract, however it kept encouraging the plaintiff to obtain the regulatory approval providing assurance that a contract will be concluded. This behaviour constituted deliberate deception as the defendant was only interested in getting the regulatory approval for its property with no intention of completing the transaction with the plaintiff.

When a negotiator is subjected to hard ball tactics at such an advanced stage of negotiation, short of a binding contract, she may fall into a sunk cost trap. The negotiator may be unwilling to walk away from the contract when she has invested resources, money, time and energy. One also has a desire to stick to earlier decisions.[31] In such a scenario, the negotiator to recover the sunk costs may lose sight of its own interests and may be keen to finalize the deal through a formal contract.

However, it may often be the case that a party may feel it is entitled to withdraw from entering into a binding contract at an advanced stage since the negotiations were "subject to contract". This view is supported by the characterization of negotiation as an adversarial process[32]. If the bargain becomes unfavourable, the negotiator may feel justified in abandoning it and may blame the other party for relying on any assurance before a binding contract has

[26] *Tough Skills for Tough Negotiations IN* N. ALEXANDER ET. AL., NEGOTIATION: STRATEGY STYLE SKILLS (3rd ed. 2015).
[27] Ibid.
[28] Edward Wertheim, *Helping Students Identify and Respond to Hardball Tactics in Negotiation*, 43 DEV. BUS. SIMULATION & EXPERIENTIAL LEARNING 1 (2016).
[29] Supra Note 23.
[30] Supra Note 11.
[31] Ibid.
[32] Supra note 4.

been entered. Such behaviour is indicative of a positional bargaining approach where the emphasis is on one's own interests rather than mutual gains.

As can be seen from the above discussion, the narrower approach towards estoppel adopted by the English law promotes employment of hard ball techniques. The negotiator can exempt itself from liability at the negotiation stage by claiming that the reliance of the other negotiator on the its assurances was misplaced as the negotiations were "subject to contract". Hard ball techniques, often employed in competitive negotiations, lead to less effective outcomes as compared to interest based or cooperative negotiations[33]. The hard ball tactics hinder the parties' ability to pursue a constructive negotiation because it may often illicit a caveman response from the other party who may also pursue similar competitive strategies[34]. The perusal of competitive tactics may make it difficult for the parties to expand the pie. It may also damage the relationship between the parties.[35]

Though competitive tactics are not always unethical, there is considerable literature which characterises hardball techniques especially deception (e.g. making false promises) as unethical[36]. Additionally, there may be higher standards of ethics applicable to lawyers. The negotiations should encompass the principle of fair dealing. Legal ethics may require a lawyer to "not accept a result that is unconscionably unfair to the other party."[37]

However, the adoption of the broader approach towards estoppel employed by Australian courts may prevent the parties from employing such hard ball techniques. The negotiator will be liable for inducing the other party to rely on her representations and compensating the sunk cost investments incurred by the other party . The application of liability through estoppel will expand the pie by not only decreasing competitive tactics but will also incentivize pre-contractual investments that will increase the contractual pie[38]. Such an approach will also decrease the employment of ethically questionable techniques. For instance,

[33] *Interest-based Negotiation IN* N. ALEXANDER ET. AL., NEGOTIATION: STRATEGY STYLE SKILLS (3rd ed. 2015).
[34] N. Alexander, "Dirty Tricks and Tactics" (lecture taught at School of Law, Singapore Management University).
[35] Supra Note 28 at p. 1
[36] R.J. LEWICKI, NEGOTIATION 54 (2nd ed. 1994).
[37] Judge Alvin B. Rubin, *A Causerie on Lawyer's Ethics in Negotiation*, 35 LOUISIANA LAW REV. 591 (1975).
[38] Omri Bin-Shahar, *Contracts without Consent: Exploring a New Basis for Contractual Liability*, 152 U. PENN. L. REV 1829.

it may reduce instances of parties entering into negotiations with an innocent party solely with the intention of extracting information from an adversary or mounting pressure on a third party to secure a better deal rather than to transact with this party[39].

However, the current doctrine of estoppel also places certain conditions on the promise for seeking relief. The Australian courts require that to invoke estoppel the reliance placed by a party on the representations should be reasonable[40]. As it is known, there is a gap between the intention of the negotiator sending a message and the interpretation of the message by the receiving negotiator[41]. The requirement of reasonableness in placing reliance would motivate the receiving negotiator in engaging in active listening. The receiver can clarify the meaning of the message with the sender of the message. This will avoid a *Crown Mebourne Ltd. v. Cosmopolitan Hotel (Vic) Pty Ltd.* like situation where a "vaguely encouraging" statement about renewal of lease was interpreted to mean as a promise to future conduct by the receiver of the message[42].

Regulatory Recommendations

It has been argued above that the adoption of the Australian approach towards the principle of estoppel shapes constructive negotiation behaviour as opposed to the English approach. However, I would recommend that negotiation behaviour can be further improved by adopting the civil law doctrine of *culpa in contrahedo*. The doctrine holds that a negotiating party is liable for negligently creating an expectation for the other party that a contract will be concluded, when he knows or should know that the expectation will not come to fruition[43].Unlike Australian law, the doctrine of *culpa in contrahedo* does not require the high threshold of unconscionable conduct by the promisor for imposing pre-contractual liability. Additionally, there is a positive obligation on the negotiating party to disclose information that may be of relevance to the other negotiating party's decision making, provided that the other party cannot obtain such information and the former party is aware of the fact[44]. The underlying

[39] Ibid.
[40] Supra Note 21.
[41] Negotiation: Larger-than-life Communication *IN* N. ALEXANDER ET. AL., NEGOTIATION: STRATEGY STYLE SKILLS (3rd ed. 2015).
[42] Supra Note 21.
[43] Friedrich Kessler and Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study* 77 HARV. L. REV. 401 (1964).
[44] Ibid.

basis for the doctrine *culpa in contrahedo* is the relationship of trust and fair dealing in the negotiations of the contract. [45]

The emphasis on disclosure of information and generating trust are essential elements of an interest based negotiation. The negotiations are more effective when parties are willing to share information.[46] The parties also tend to avoid competitive negotiation techniques when there is trust between the parties[47] which in turn adds value to the contractual pie. Aggressive competitive techniques like playing hardball also decrease if the parties have an ongoing relationship[48]. Hence, it will be beneficial for common law countries to draw inspiration from the said doctrine for shaping negotiation behaviour.

Conclusion

This paper has argued that a liability for a retraction should be imposed once the negotiators have evaluated the 'options' and arrived at an agreement regarding their respective contributions, short of a binding contract. This will protect the sunk cost investments of a party from a sudden change of heart of the other party. Such a liability would promote constructive negotiation behaviour by reducing usage of hardball techniques and deception. The liability will also incentivize interest based negotiations which have been found to be more effective. The paper further recommends that to further promote cooperative and ethical behaviour the common law jurisdictions may employ the civil law doctrine of *culpa in contrahedo* in appropriate cases.

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