Notes From The Field
An English Law Perspective On The Oil & Gas Market

A Drafting Reminder: Remember the Recitals  |  November 2014

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“IT IS A TRUE RULE OF CONSTRUCTION THAT THE SENSE AND MEANING OF THE PARTIES IN ANY PARTICULAR PART OF AN INSTRUMENT MAY BE COLLECTED EX ANTECEDENTIBUS ET CONSEQUENTIBUS: EVERY PART OF IT MAY BE BROUGHT INTO ACTION IN ORDER TO COLLECT FROM THE WHOLE ONE UNIFORM AND CONSISTENT SENSE, IF THAT MAY BE DONE.”

It is often the case that where commercial contracts include a recitals section preceding the operative provisions, the recitals will be among those sections of the contract that have been afforded the least consideration by the contracting parties during the drafting stages. There is a widely-held perception that the recitals are legally inconsequential, since their role is fundamentally ‘scene-setting’ in nature and they do not automatically form part of the operative, legally binding agreement between the contracting parties. However, when a dispute arises over contractual interpretation and a court or arbitrator is tasked with deciphering an ambiguous provision, the recitals may be brought into play as an aid to interpretation. They are, after all, clearly a part of the written contract in some way or other.

This article seeks to restate the importance of the humble recital, and to serve as a reminder that the recitals could be legally binding upon the contracting parties in certain circumstances, and that they could also play an important role in enabling a third party (crucially, a court of law or an arbitrator) to refer to relevant background information in order to discover the true intention of the contracting parties.

What constitutes a binding contract?

The four essential components of a binding contract under English law are offer, acceptance, consideration and intent to create legal relations. Provided each of these elements is satisfied, a binding contract will exist regardless of the form (written or oral) through which the contract comes into being. Despite such flexibility being afforded to the draftsmen, commercial contracts tend to follow a typical structure, comprising the following components (although not necessarily in the following order):

- the preamble (often including the effective date and identifying the parties);
- the recitals;
- the definitions;
- the interpretation clauses;
- the operative provisions (also commonly referred to as the ‘body’, containing the key terms governing the rights and obligations of the parties);
- the boilerplate (including force majeure, confidentiality, an entire agreement clause, severability provisions etc.); and
- any schedules (adding detail to specific operative provisions).

This leads to the question of precisely which parts of the contract form the legally binding agreement, by reference to the express provisions as agreed between the contracting parties. If the answer to this question is not the contract in its entirety, then it should be clear where the legally binding rights and obligations begin and end.

What are the recitals?

Recitals are not compulsory, but are frequently included in commercial contracts to set out the background to the contract. There is no prescribed format for drafting the recitals, but they typically contain concise statements of fact, describing key circumstances and details relevant to the establishment of the contract. Expressions of intent and references to any related contracts may also be included. In some contracts, the advent of the recitals is helpfully indicated by introductory text which states “RECITALS”. Contractual obligations should not be included in the recitals, but are more appropriately placed in the
legally binding operative provisions. The same principle applies to key definitions.

The recitals can play a valuable role in helping third parties entering into, or reviewing, the contract later in time to understand the intention of the original contracting parties. The reality is that the commercial intent behind a written contract is not always readily apparent from the substantive provisions. Parties to a contract may be surprised to find that their carefully drafted provisions, which may have appeared unequivocal at the time of drafting, are in fact ill-equipped to address unforeseen issues which arise once the contract has taken effect. This is because the contract is likely to have been subject to protracted negotiations (as is often the case with complex commercial contracts), with the final wording representing a compromise reached between opposing commercial standpoints.

In contrast, the recitals section is fundamentally explanatory in nature and is, therefore, likely to be one of the few (comparatively) neutral sections of the contract, containing the clearest and most frank statements made by the parties in the course of their negotiations.

So where do the recitals end and the operative provisions begin?

The answer to this question is one of form rather than substance. It is common to find that the beginning of the substantive obligations is clearly signposted, for example with the following language:

“Now, THEREFORE, and in consideration of the mutual promises, terms and conditions stated herein, the parties do now AGREE as follows:”.

However, such verbiage is not necessary and it is equally effective to say:

“The parties agree as follows” or “Now it is hereby agreed”.

It is from this point that the heart of the contract, containing the legally binding rights and obligations between the parties, is set out. Whether there is clear language to this effect or not, it is important to look to the interpretation clauses which are usually found immediately following the definitions clause, which should stipulate which parts of the contract form part of, or are excluded from, the legally binding agreement. Schedules to the contract (which commonly contain further key terms of the contract) will often be expressly stated to be treated as part of the contract, and will therefore be given legal effect.

Where contracting parties include an interpretation clause in their contract but do not include specific reference to the recitals in such clause, it could be inferred from such omission that the parties have chosen to exclude the recitals from forming part of the legally binding sections of the contract. Where the parties do not include an interpretation clause at all, it might be assumed that the recitals are not intended to be legally binding. In either circumstance, the recitals might not be treated as having legal effect. However, this will not affect their admissibility in a dispute if the operative provisions are ambiguous.

Key definitions which are used throughout the operative part of the contract are more appropriately placed in the definitions section of the contract rather than in the recitals, given that the recitals might not have legal effect. This is not necessarily the approach adopted in practice, as is the case with the Association of International Petroleum Negotiator’s (AIPN) 2012 model form joint operating agreement (AIPN JOA). In the AIPN JOA, the term “Contract” is defined in the recitals by reference to the underlying production sharing contract, government concession, license, lease or other instrument in respect of that particular JOA. “Contract” is then defined in the definitions section as “the instrument identified in the recitals to this Agreement including any extensions, renewals, and/or amendments”.

To ensure key definitions are brought within the legally binding contract, a better approach could be to include the wording “as hereinafter defined” immediately preceded by the defined term in the recitals, thereby implicitly directing the reader to the definitions section in the operative part of the contract. In practice, however, it is unlikely that a court will disregard all references to defined terms in the recitals in construing the agreement.
What about the rules relating to pre-contractual negotiations?

Pre-contractual negotiations (evidence of which may be included in the recitals) are usually inadmissible as a tool of construction in contractual disputes. Under English law, there is a (rebuttable) presumption that a written contract is deemed to contain the entire agreement between the parties (the “exclusionary rule”). However, pre-contractual negotiations may be admissible for the purposes of establishing facts relevant to the background of the contract, such as the commercial purpose of the transaction. Information included in the recitals that could assist a court or an arbitrator to establish context could therefore be relied upon in a dispute.

The parties should be mindful of the application of an entire agreement clause. Such a clause is commonly found in commercial contracts and prevents any preceding statements or representations that are not expressly incorporated into the contract from having legal effect. To ensure that any relevant background information or representations contained in the recitals do not fall foul of an entire agreement clause, the recitals will need to be expressly incorporated into the agreement. An alternative approach could be to state that an entire agreement clause applies “unless the context otherwise requires”. However, such qualifier is vague, and may not be desirable given that it may promote uncertainty.

When are the recitals likely to be admissible?

Crucially, the recitals are subordinate to the operative provisions of a contract if there is no doubt as to the meaning of the express words of a contract. In this circumstance, the parties are governed entirely by the operative part of the contract and the recitals cannot be resorted to. However, where there is ambiguity in the contract, a court may look to the recitals for evidence of the true intention of the parties, as well as for guidance as to how a disputed provision should be construed.

For this reason, the importance of careful drafting of the recitals should not be dismissed. A well-drafted recital could influence a court or an arbitrator to favour one party’s argument over that of the other. For example, consideration of whether a term should or should not be implied into a contract may be influenced by evidence in the recitals as to the intentions of the parties. In addition, if a court views a recital as manifesting a clear intention to act in a prescribed way, it may infer a covenant to so act. The recitals should accurately reflect the factual matrix as they have been known to represent “agreed statements”. Therefore, even if a statement in the recitals contains the acknowledgement of an established fact which both parties know at the time to be untrue, such statement could nevertheless be binding on the parties in the event that the recitals are relied upon.

How can you ensure the recitals will be taken into consideration?

The recitals may so meritoriously set out the fundamental objectives of the contract that the contracting parties may seek to ensure that they will be taken into consideration under all circumstances, even where it may appear that the operative provisions are unequivocal. If this is the case, the parties should incorporate the recitals into the contract by including an express provision in the operative provisions (usually in the interpretation clauses) that the recitals are to form part of the contract. They will therefore be regarded as having legal effect. A word of caution, should this approach be taken: the contracting parties should ensure that the recitals are consistent with the operative provisions of the contract to avoid issues concerning inconsistent interpretation, particularly if there are any obligations within the operative provisions that have been referenced or summarised in the recitals.

The AIPN’s 2006 model form gas sales agreement states that its interpretation clause applies to “this Agreement, including the recitals and Attachments, except where expressly provided to the contrary: . . . in the event of a conflict, the provisions of the main body of this Agreement shall prevail over the provisions of the Attachments”. The fact that there is no mention of the recitals in the second half of this provision suggests that it is assumed that the recitals will not take precedence over the operative provisions (except, as discussed earlier, where there is ambiguity) and that there is therefore little need to make an express statement to this effect.
Is it possible to exclude the effectiveness of the recitals completely?

As stated earlier, in the absence of any provision to the contrary, the recitals will not have legal effect where the contract is clear, but where there is ambiguity in the contract a court or an arbitrator may look to them to aid its interpretation as to the parties’ intentions. The best way for contracting parties to ensure that the recitals will not need to be relied upon in a dispute is to use clear and unequivocal language in the operative provisions, and to ensure that the rights and obligations set out are capable of a single interpretation (and that such interpretation is the one intended). The parties can choose to expressly exclude the recitals from being legally binding and effective upon them, but this does not guarantee that they will be disregarded completely in certain disputes.

Conclusion

Whether the recitals may or may not have legal effect will depend on the construction of the particular contract, taken as a whole. The most significant effect attaching to the recitals is the potential for a court or an arbitrator to look to their content where a dispute arises over contractual interpretation as a result of ambiguity in the main body of the contract. Given their capacity to influence a court, contracting parties should think carefully about their reasons for including specific information in the recitals, the desired purpose to be served by each statement or representation and ultimately, whether these will have legally beneficial effects for either or both of the parties. Where included, the recitals should be viewed as legal provisions as opposed to merely introductory prose, and therefore drafted with the same level of thought and precision as the operative provisions of the contract.

1. Lord Ellenborough, C.J. in Barton v Fitzgerald (1812) 15 East 530
2. Prenn v Simmonds [1971] 1 W.L.R. 1381
3. In Chartbrook Ltd v Persimmon Homes Ltd [2008] 1 A.C. 1101, the pre-contractual negotiations were found to constitute part of the background knowledge required to interpret a contractual term, and such evidence was therefore admissible.
4. Brett L.J in Leggott v Barrett (1880) 15 Ch. D. 306
5. Rust Consulting Ltd (In Liquidation) v PB Ltd (formerly Kennedy & Donkin Ltd) [2012] 1 All E.R. (Comm) 455. The court referred to the specific wording of the factual matrix set out in the recital, namely that under the terms of a separate agreement the defendant would “assume all of [Rust’s] liabilities and obligations”, as confirmation of the parties intentions.
6. Aspdin v Austin (1844) 1 QB 671
7. Prime Sight Ltd v Lavarello (Gibraltar) [2014] 2 W.L.R. 84
8. The parties can take comfort from the fact that where it is the recitals themselves that have introduced uncertainty into the agreement, the operative sections will prevail.