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PRELIMINARY AGREEMENTS

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Commercial parties often negotiate a preliminary document with the intention of replacing that document with a more formal document at a later stage. In some circumstances it is difficult to determine whether the preliminary document was intended to have contractual effect. When faced with resolving such problems courts adopt a two-stage process of inquiry. The first, and most crucial inquiry, is to determine whether the parties intended to be bound. If not, there is no contract. However, if the parties did intend to be bound the court conducts a second inquiry to determine whether the parties' agreement is complete and certain enough to be a contract. The modern trend has led courts to increasingly hold that a contract exists even where there are substantial gaps in the agreement concluded by the parties. This modern trend can be contrasted with the more traditional position where courts were prepared to hold that no contract existed where parties had left essential matters to be agreed to at a later time. Despite this modern trend some courts, when deciding whether the parties intended to be bound, continue to place more weight on factors such as the absence of an essential term than they do on factors such as part performance. Courts are faced with finding a balance between not imposing contracts on parties and not making contracts for them on the one hand, and on the other hand courts not wishing to be accused of being the destroyer of bargains.

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I. INTRODUCTION

In a number of contract cases the courts are faced with the task of determining whether a contract exists between the parties. The problem is particularly highlighted in cases where the parties enter into some form of preliminary agreement with the express intention of replacing it with a more formal agreement at a later time. This is not the situation in all cases but a vast majority of the cases in this area have involved preliminary agreements. The question then is whether the parties are still negotiating or whether their negotiations have crystallised into an enforceable contract.

The problem essentially involves whether the parties in fact intended to be bound at a point in time and if they did, whether what they agreed to at that time is complete and certain enough to be an enforceable contract. This two-stage process of inquiry has been widely adopted by the courts and was utilised in three recent leading cases – *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[1] in Western Australia, *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[2] in New Zealand and *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd*[3] in New South Wales. This approach has also been adopted in a number of cases in the United Kingdom,[4] Canada[5] and in the United States.[6]

The two-stage approach is essentially a practical method of addressing a single question of whether the parties have formed a contract. It represents a process that can be applied to a variety of

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1 (2000) 22 WAR 101.

2 [2002] 2 NZLR 433.

3 (2005) 12 BPR 23,021.

4 See especially *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601, 619 (Lloyd LJ).

5 See especially Canada Square Corp Ltd v Versafood Services Ltd (1982) 130 DLR (3d) 205; and Bawitko Investments Ltd v Kernels Popcorn Ltd (1991) 79 DLR (4th) 97.

6 See especially *American Cyanamid Co v Elizabeth Arden Sales Corp,* 331 F Supp 597 (SDNY 1971); and *Reprosystem BV v SCM Corp* 727 F 2d 257 (2nd Cir 1984). See also Andrew Klein, 'Devil's Advocate: Salvaging the Letter of Intent' (1988) 37 *Emory Law Journal* 139, 144; and Harvey Temkin, 'When Does the "Fat Lady" Sing?: An Analysis of "Agreements in Principle" in Corporate Acquisitions' (1986) 55 *Fordham Law Review* 125.

factual scenarios to determine whether a contract has been formed. The process is somewhat imprecise because it relies on the consideration of a number of factors in each of the two-stages of the process rather than a defined test. But that imprecision is unavoidable in the circumstances because determining whether a contract is formed is not capable of being reduced to a precise test. The two-stage approach has essentially emerged over time as a useful method of determining the issue of contract formation in the context of preliminary agreements. There is also a degree of overlap between the two stages. This is because the absence of essential terms is relevant in considering the intention of the parties and also in relation to whether the agreement is sufficiently complete to be a contract. Despite this overlap the two-stage approach does provide a useful process to resolve the issue of whether a preliminary agreement is a contract.

In relation to the issue of whether parties intended to be bound it will be argued that there is a divergence of opinion, particularly in relation to what weight should be attached to different factors that indicate whether the parties intended to be bound or not. It will be argued that there is now general agreement, in relation to the issue of incompleteness, that a court should complete an agreement if the court is satisfied that the parties intended to be bound. This is especially so in cases where there has been partial performance under the agreement. Essentially the courts have, over time, moved to a position where they are willing to fill gaps in agreements to hold parties to their bargains. This has stretched the traditional concept of contract formation to new limits where the courts are playing an active role in assisting in the contract formation process. The courts could have taken a different path and determined that agreements with too many gaps will be held not to be contracts and developed estoppel to provide a remedy in appropriate cases. However, as the cases examined in this paper demonstrate the courts have clearly adopted a strategy of resolving the issue of preliminary agreements by developing the rules relating to contract formation.

Three approaches adopted by the courts to fill gaps will be examined. The first relies on the presence of ‘a skeleton of

essential terms'[7] and the second approach considers whether what the parties have agreed to is 'not unworkable'.[8] The third approach considers each gap individually to determine whether that gap can be filled.[9] It will be shown that all of these approaches can be used in appropriate circumstances.

It will be argued that when addressing the issue of intention to be bound the different outcomes in some jurisdictions is primarily the result of the weight placed on the relevant factors. Courts in Australia place considerable weight on the actual language used by the parties, any partial performance under the agreement and the subsequent conduct of the parties. However, courts in New Zealand have at times placed more weight on the absence of essential terms and the nature and importance of the transaction.

This paper is divided into three parts. In part one the nature of preliminary agreements will be examined. In part two intention to be bound will be examined and in part three issues related to incompleteness will be addressed.

II. PART ONE – THE NATURE OF PRELIMINARY AGREEMENTS

A. *Use of preliminary agreements*

Preliminary documents or agreements are referred to by a number of descriptions including letters of intent, heads of agreement,[10] memorandum of understanding, letters of understanding, memorandum of intent[11] and commitment

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7 *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433, 448 (Richardson P, Keith, Blanchard and McGrath JJ).

8 *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101, 127 (Ipp J).

9 *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd* (2005) 12 BPR 23,021 at 23,035 (Young CJ in Eq).

10 See Jane Knowler and Andrew Stewart, 'When is an Agreement not a Contract? The Uncertain Status of Heads of Agreement and Other Preliminary Commercial Arrangements' (2004) 18(2) *Commercial Law Quarterly* 21.

11 Ugo Draetta and Ralph Lake, *Letter of Intent and Other Precontractual Documents* (1994) 4–5.

letters.[12] When referring to these documents, courts often for convenience refer to them as *agreements* and then seek to determine whether they are *contracts*. The use of the term agreement in this paper is, therefore, not intended to imply that there is a contract. Preliminary agreements may also comprise an exchange of letters, faxes or other correspondence and may be partly or wholly oral. A further category involves comfort letters[13] which are letters provided by one person to indicate some form of financial support for another person. A comfort letter differs from a preliminary agreement because a comfort letter is a document provided by one party only and is, therefore, not prima facie contractual in nature. They are generally provided in conjunction with a loan contract and therefore may or may not form part of the overall contractual relationship. Although sometimes involving similar issues, comfort letters are beyond the scope of this paper and will not be considered.

Schmidt[14] notes that preliminary agreements are often used in negotiation of complex matters where the parties 'have reached a point of no return in the negotiation, and decide that the agreement already realised about certain elements will be considered as a definitive contract, in spite of the fact that other points remain under discussion'.[15] It is clear that when preliminary agreements are used in this way they should, if they are sufficiently complete, be binding on the parties. However, according to Holmes,[16] parties who have not yet completed

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12 Ross Cranston, 'Banking Law – Commitment Letters' (1988) 62 *Australian Law Journal* 286, 286.

13 For comment on comfort letters see Andrew Ayres and Adrian Moore, '"Small Comfort" Letters' (1989) *Lloyd's Maritime and Commercial Law Quarterly* 281; Ian Brown, 'The Letter of Comfort: Placebo or Promise?' (1990) *Journal of Business Law* 281; Davenport BJ, 'A Very Comfortable Comfort Letter' (1988) *Lloyd's Maritime and Commercial Law Quarterly* 290; Prentice DD, 'Letters of Comfort' (1989) 105 *Law Quarterly Review* 346; Reynolds FMB, 'Uncertainty in Contract' (1988) 104 *Law Quarterly Review* 352, 355; and Tettenborn AM, 'Commercial Certainty – A step in the Right Direction?' (1988) 47 *Commercial Law Journal* 346.

14 Joanna Schmidt, 'Preliminary Agreements in International Contract Negotiation' (1983) 6 *Houston Journal of International Law* 37.

15 Ibid 53.

16 Wendell Holmes, 'The Freedom not to Contract' (1986) 60 *Tulane Law Review* 751.

negotiations on all material terms may use a letter of intent to memorialise the substance of their agreement at its current stage and to provide an impetus to consummate the bargain.[17] Holmes is suggesting that such preliminary documents serve only as a useful aid to further contractual negotiations and should not be held to be binding. The fact that preliminary agreements are frequently used by parties that intend to be bound and by those that do not, only adds to the difficulty courts face in determining the intention of the parties. The situation is further complicated when one party is attempting to bind the other party without intending to be bound themselves. As Draetta[18] observes, in the modern usage of preliminary agreements each party 'seems to be preoccupied by the concern of binding the other not to rediscuss the points of agreement recorded in the letter of intent, while at the same time preserving for itself the freedom to rediscuss said points'.[19]

B. *Categories of preliminary agreements*

The High Court of Australia has placed these agreements into a number of categories in an attempt to differentiate between situations where the parties have a contract and situations where they do not. In *Masters v Cameron*[20] the High Court described three of these categories. A fourth category had previously been identified in *Sinclair, Scott & Co Ltd v Naughton*[21] and has been accepted as a valid category in a number of cases.[22] These four categories are:

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17 Ibid 777.

18 Ugo Draetta, 'The Pennzoil Case and the Binding Effect of the Letter of Intent in International Trade Practice' (1988) 2 *International Business Law Journal* 155.

19 Ibid 157.

20 (1954) 91 CLR 353.

21 (1929) 43 CLR 310.

22 See, eg, *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101; *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) 40 NSWLR 622; *Brunninghausen v Glavanics* (1999) 46 NSWLR 538; *Graham Evans Pty Ltd v Stencraft Pty Ltd* (2000) 16 BCL 335; *Heysham Properties Pty Limited v Action Motor Group Pty Limited* (1998) 14 BCL 145; *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* (2002) 18 BCL 57; and *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601.

(a) Cases in which the parties 'have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of those terms, but at the same time propose to have the terms restated in a form which will be fuller or more precise but not different in effect'.[23]

(b) Cases in which the parties 'have completely agreed upon all the terms of their bargain and intend no departure from or addition to that which their agreed terms express or imply, but nevertheless have made performance of one or more of the terms conditional upon the execution of a formal document'.[24]

(c) Cases in which 'the intention of the parties is not to make a concluded bargain at all, unless and until they execute a formal contract'.[25]

(d) Cases where the parties are 'content to be bound immediately and exclusively by the terms which they have agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms'.[26]

In *Masters v Cameron*[27] the court determined that in agreements in the first and second category there is a binding contract but that agreements in the third category do not have any binding effect of their own.[28] In relation to the third category the court considered that the parties 'may reserve to themselves a right to withdraw at any time until the formal document is signed'.[29] Often a court is faced with the task of deciding whether a case falls within the third category in *Masters v Cameron*[30] or the

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23 *Masters v Cameron* (1954) 91 CLR 353, 360 (Dixon CJ, McTiernan and Kitto JJ).

24 Ibid (Dixon CJ, McTiernan and Kitto JJ).

25 Ibid (Dixon CJ, McTiernan and Kitto JJ).

26 *Sinclair, Scott & Co Ltd v Naughton* (1929) 43 CLR 310, 317 (Knox CJ, Rich and Dixon JJ).

27 (1954) 91 CLR 353.

28 Ibid 360–361 (Dixon CJ, McTiernan and Kitto JJ).

29 Ibid 361 (Dixon CJ, McTiernan and Kitto JJ).

30 (1954) 91 CLR 353.

fourth category identified in *Sinclair, Scott & Co Ltd v Naughton.*[31] That is, have the parties reserved a right to withdraw or have they agreed to be bound.

There has been some recent debate on whether the fourth category exists at all. Peden, Carter and Tolhurst[32] argue that the fourth category does not exist and that courts should not devote time to 'inventing new and unnecessary law'.[33] However, in *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd*[34] Young CJ in Eq was unimpressed with that argument and suggested that an article by academics attacking the considered view of 'one of the greatest equity judges of the twentieth century … does not rate serious consideration'.[35] Young CJ in Eq concluded that the agreement before the court fell within the fourth category.[36] It may be that further categories will be identified in the future. For example, the parties might enter into an initial agreement that they intend to be a binding contract but express an intention to enter into a subsequent agreement which is intended to supplement the first agreement rather than replace it entirely.[37]

Circumstances may arise where the parties enter into an agreement that is subject to the negotiation of a formal contract but despite the parties failing to enter into such a formal contract they commence performance under the initial agreement. In such cases the courts are faced with the contradiction that the initial agreement is subject to contract, and therefore should not be binding, but the parties have commenced performance and thus at least one party will be seeking to enforce the initial agreement. The issue is resolved by concluding that the condition that a formal contract is entered into is a suspensory condition and that

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31 (1929) 43 CLR 310.

32 Elisabeth Peden, John Carter and Greg Tolhurst, 'When Three Just Isn't Enough: the Fourth Category of the 'Subject to Contract Cases' (2004) 20 *Journal of Contract Law* 156.

33 Ibid 166.

34 (2005) 12 BPR 23,021.

35 Ibid at 23,030. See also RI Barrett, 'Masters v Cameron: The Fourth Class is Here to Stay' (2005) 79 *Australian Law Journal* 493.

36 Ibid at 23,031. Both Hodgson JA and Stein AJA agreed.

37 See *Motor Trade Finances Prestige Leasing Pty Ltd v Elderslie Finance Group Corp Ltd* [2006] NSWSC 1348 (Unreported, White J, 8 December 2006).

performance of the initial agreement amounts to a waiver of the suspensory condition.[38]

A number of scholars[39] have also sought to distinguish between different categories of preliminary agreements to assist in identifying which types of agreements courts should find to be enforceable contracts. These agreements fall into two broad categories – agreements with some terms still to be resolved ("agreements to agree" or "agreements with open terms") and agreements to negotiate. The former will be enforced if the parties intended to be bound and if the courts can imply reasonable terms to fill the gaps and the latter are generally held to be unenforceable,[40] however the potential enforceability of agreements to negotiate is beyond the scope of this paper.

III. PART TWO – INTENTION TO BE BOUND

A. *Is there a presumption that a preliminary agreement is binding?*

An issue in relation to preliminary agreements is whether there should be a presumption that they are intended to be binding, a presumption that they are not binding or whether the courts

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38 See *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd* [2006] VSC 432 (Unreported, Habersberger J, 15 November 2006).

39 See A M Dugdale and N V Lowe, 'Contracts to Contract and Contracts to Negotiate' (1976) *Journal of Business Law* 28; Allan Farnsworth, 'Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations' (1987) 87 *Columbia Law Review* 217; Charles Knapp, 'Enforcing the Contract to Bargain' (1969) 44 *New York University Law Review* 673; Barbara McDonald and Jane Swanton, 'Contract Law – Agreements to "negotiate", "deal", "consult" or "confer" ' (1992) 66 *Australian Law Journal* 744; and George Winterton, 'Is an "Agreement to Agree" Unenforceable?' (1969) 9 *Western Australian Law Review* 83.

40 Ross Buckley, 'Walford v Miles: False Certainty About Uncertainty – An Australian Perspective' (1993) 6 *Journal of Contract Law* 58. See *Walford v Miles* [1992] 2 AC 128. For a leading Australian case see *Coal Cliff Collieries v Sijehama Pty Ltd* (1991) 24 NSWLR 1. For an English perspective see Ian Brown, 'The Contract to Negotiate: A Thing Writ in Water?' (1992) *Journal of Business Law* 353. For a Canadian perspective see Joost Blom, 'Judicial Law Reform in the Law of Contract' (1988) 23 *University of British Columbia Law Review* 5.

should adopt a neutral position. The position amongst scholars[41] is supportive of the view that there should be a presumption that preliminary agreements are *not* binding. However, with some exceptions, judicial opinion is strongly supportive of a neutral position.

In *Ermogenous v Greek Orthodox Community of SA Inc*[42] the issue was whether the parties to an employment arrangement intended to create legal relations at all. In that context the majority of the High Court addressed the issue of presumption and held that 'we doubt the utility of using the language of presumptions in this context'.[43] In *Toyota Motor Corp v Ken Morgan Motors*[44] Tadgell J addressed the issue of whether there should be a presumption that a party intended to be bound and adopted a neutral position by concluding that 'there can be no presumption of an intention to make a promise'.[45] The majority in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[46] also adopted a neutral approach when they stated that the court 'has an entirely neutral approach when determining whether the parties have entered into contractual relations'.[47]

In *Sheehan v Zaszlos*[48] the Queensland Court of Appeal identified an exception to the neutral approach where the parties intend to contract in accordance with a common practice. In such

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41 See Draetta and Lake, above n 11, 5; M P Ellinghaus, 'Agreements Which Defer "Essential" Terms Part I' (1971) 45 *Australian Law Journal* 4, 7; Farnsworth, above n 39, 256; Klein, above n 6, 142; Richard Mahon and John Walton, 'Navigating the Tender Process' (2001) *New Zealand Law Journal* 346, 349; and Russell Weintraub, 'The Ten Billion Dollar Jury's Standards for Determining Intention to Contract: Pennzoil v Texaco' (1990) 9 *Review of Litigation* 371, 381.

42 (2002) 209 CLR 95.

43 Ibid 106 (Gaudron, McHugh, Hayne and Callinan JJ).

44 [1994] 2 VR 106.

45 Ibid 177 (Tadgell J).

46 [2002] 2 NZLR 433.

47 Ibid 445. *Cf. Concorde Enterprises v Anthony Motors (Hutt) Ltd* [1981] 2 NZLR 385, 389 (Cooke P); and *Shell Oil v Wordcom Investments* [1992] 1 NZLR 129, 130 (Cooke P).

48 (1995) 2 Qd R 210. For comment on this case see David Caspersonn, 'Masters v Cameron – A Common Problem' (1997) 11 *Commercial Law Quarterly* 17.

circumstances 'it may be readily inferred that they did not contemplate the coming into existence of a binding contract except in accordance with that practice'.[49] Such a common practice exists in cases involving the sale of real estate. In *Marek v Australasian Conference Association Pty Ltd*[50] Cooper and Byrne JJ suggested that a presumption against a binding contract in the sale of land might exist and the parties 'will not be taken to have made a concluded bargain unless and until a formal contract is executed'.[51] A similar position exists in New Zealand[52] and in New South Wales.[53]

The same presumption may also arise where the parties make an oral agreement when the subject matter is a substantial commercial transaction. This issue arose in *RT & YE Falls Investments Pty Ltd v The State of New South Wales*[54] where Palmer J held that it would be rare 'to find that parties negotiating a substantial commercial transaction in the expectation of a formal contract will, by a series of conversations, have evidenced a common intention to be contractually bound prior to the terms of their agreement being embodied in a formal, executed contract'.[55]

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49 [1995] 2 Qd R 210, 213.

50 [1994] 2 Qd R 521.

51 Ibid 527 (Cooper and Byrne JJ).

52 See, eg, *Carruthers v Whitaker* [1975] 2 NZLR 667, 671 (Richmond J). See also David McLauchlan, '"We Have a Deal" Mere Consensus or Concluded Bargain?' (1996) 2 *New Zealand Business Law Quarterly* 205.

53 See especially, *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd* (1986) 40 NSWLR 631; and *Penrith City Council v Robose Pty Ltd* [2002] NSWSC 599 (Unreported, Palmer J, 27 June 2002). See also *Hall v Busst* (1960) 104 CLR 206; *Stock & Holdings (Constructors) Pty Ltd v Arrowsmith* (1964) 112 CLR 646; and *Bridle Estates Pty Ltd v Myer Realty Pty Ltd* (1977) 51 ALJR 743. See also see Harrison WN, 'Hall v Busst' (1961) 35 *Australian Law Journal* 3; K Sutton, 'Certainty of Contract' (1977) 7 *Queensland Law Society Journal* 5; and Horst Lucke, 'Illusory, Vague and Uncertain Contractual Terms' (1977–78) 6 *Adelaide Law Review* 1.

54 [2001] NSWSC 1027 (Unreported, Palmer J, 15 November 2001).

55 Ibid [57]. See also *Device Technologies Australia Pty Ltd v Applied Medical International Inc* [2001] NSWSC 1110 (Unreported, Palmer J, 6 December 2001); and *Fitzwood Pty Ltd v Unique Goal Pty Ltd* (2002) 188 ALR 566.

It is submitted that it is appropriate for courts to adopt a neutral approach, as is done in Australia and New Zealand, except where the court is satisfied that a particular practice exists. There are now two established categories when the court should presume that the parties did not intend to be bound. These are the sale of real estate and substantial commercial transactions when the alleged contract is wholly oral. Further categories may, however, be established in the future.

B. *Identification of the factors to be considered*

The difficulty of prescribing any rules to the issue of whether the parties intended to create contractual obligations was addressed in *Ermogenous v Greek Orthodox Community of SA Inc*[56] where the majority of the High Court observed that the 'circumstances which might properly be taken into account in deciding whether there was the relevant intention are so varied as to preclude the formation of any prescriptive rules'.[57] In the absence of any prescriptive rules the courts have identified a number of relevant factors to be considered in determining whether the parties intended to be bound. These factors include:

(a) the language used by the parties[58] and whether there has been any express intention not to be bound;[59]

(b) whether there has been partial performance of the alleged contract;[60]

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56 (2002) 209 CLR 95.

57 Ibid 105 (Gaudron, McHugh, Hayne and Callinan JJ).

58 See especially *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101, 114 (Ipp J); *Coal Cliff Collieries v Sijehama Pty Ltd* (1991) 24 NSWLR 1; *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433; *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd* (1986) 40 NSWLR 631; and *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* (2002) 18 BCL 57.

59 See especially *Arcadian Phosphates Inc v Arcadian Corp,* 884 F 2d 69 (2nd Cir, 1989); and *Winston v Mediafare Entertainment Corporation,* 777 F 2d 78 (2nd Cir, 1985) 80.

60 See especially *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101; *Sudbrook Trading Estate Ltd v Eggleton* [1983] 1 AC 444; *SVI Systems Pty Ltd v Best & Less Pty Ltd* (2001) 187 ALR 302; and *Winston v Mediafare Entertainment Corp,* 777 F 2d 78 (2nd Cir, 1986) 80.

(c) the subsequent conduct of the parties[61] including reliance on the agreement;[62]

(d) incompleteness[63] and in particular the number of matters remaining to be determined[64] and their importance;[65]

(e) the subject matter,[66] the importance of the transaction,[67] including the inherent unlikelihood of the parties' intending to bind themselves in an informal manner in a major and complex transaction,[68] and any prior dealings

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61 See especially *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101; *Arnold Palmer Golf Co v Fuqua Industries Inc*, 541 F 2d 584 (1976); *Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540; *Barrier Wharfs Ltd v W Scott Fell & Co Ltd* (1908) 5 CLR 647; *Commercial Bank of Australia Ltd v GH Dean & Co Pty Ltd* [1983] 2 Qd R 204; *Rural Insurance (Aust) Pty Ltd v Reinsurance Australia Corp Ltd* (2002) 41 ACSR 30; and *Von Hatzfeldt-Wildenberg v Alexander* [1912] 2 AC 128.

62 See especially *Adam v General Paper Co Ltd* (1978) 85 DLR (3d) 736; *Arnott v Tundra Steel Products Ltd* (Unreported, Supreme Court of British Columbia, Melnick J, May 14, 1999) [38]; *Byrne v Napier* (1975) 62 DLR (3d) 589; *Cherewick v Moore* [1955] 2 DLR 492; and *Kay Corp v Dekeyser* (1977) 76 DLR (3d) 588.

63 See especially *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101, 110 (Ipp J); *Diamond Developments Ltd v Crown Assets Disposal Corp* (1972) 28 DLR (3d) 207; *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433; and *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601.

64 See especially *Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540; *Winston v Mediafare Entertainment Corp*, 777 F 2d 78 (2nd Cir, 1986) 80; and *Woodside Offshore Petroleum Pty Ltd v Atwood Oceanics Inc* [1986] WAR 253, 273 (Kennedy J).

65 See especially *Courtney & Fairbain Ltd v Tolaini Bros (Hotels) Ltd* [1975] 1 WLR 297; and *R & J Dempster v Motherwell Bridge and Engineering Co* [1964] SC 308.

66 See especially *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd* (1986) 40 NSWLR 631; *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601, 611 (Bingham J); and *Vass v Commonwealth* (2000) 169 ALR 486, 495.

67 See *Banking & Trading Corporation v Floete,* 257 F 2d 765 (2nd Cir, 1958); and Horst Lucke, 'Arrangements Preliminary to Formal Contracts' (1967) 3 *Adelaide Law Review* 46, 60.

68 See especially *Clifton v Palumbo* [1944] 2 All ER 497 (CA) (Lord Greene MR); *Seven Cable Television Pty Ltd v Telstra Corporation Ltd* (2000) 171 ALR 89; *Toyota Motor Corp v Ken Morgan Motors* [1994] 2 VR 106;

of the parties and any practices or customs of their trade;[69]

(f) the presence or absence of an arbitration clause[70] and;

(g) the nature of the relationship between the parties.[71]

Identifying an intention to be bound by examining these relevant factors is essentially a practical process to answer the question posed by this first stage of the two-stage inquiry. Because no single test is appropriate the courts must find a method of identifying the relevant intention. The process developed by the courts is to examine each of these factors, where they are present or relevant, to make an overall assessment of whether the relevant intention to be bound existed. It is submitted that given the nature of the question to be addressed this approach of examining the relevant factors is entirely appropriate.

C. *Language used by the parties*

It is submitted that the most significant factor to be considered in relation to intention to be bound is the language used by the parties. If the language is clear the court may not need to look at other factors. However, if the language used by the parties is ambiguous the court will look to other factors to resolve the issue. In *Alpine Hardwood (Aust) Pty Ltd v Hardys Pty Ltd*[72] Weinberg J suggested that, when interpreting the language used by the parties, courts should adopt a more liberal approach when the document has not been drafted by a lawyer.[73] This view is particularly relevant in relation to preliminary agreements

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Woodside Offshore Petroleum Pty Ltd v Atwood Oceanics Inc [1986] WAR 253, 273 (Kennedy J); and *Player v Isenberg* [2002] NSWCA 186 (Unreported, Beazley, Giles JJA and Ipp AJA, 20 June 2002).

69 See *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd* (1986) 40 NSWLR 631; *Marek v Australasian Conference Association Pty Ltd* [1994] 2 Qd R 521; and *Sheehan v Zaszlo*s [1995] 2 Qd R 210.

70 See *Calvan Consolidated Oil & Gas Co Ltd v Manning* [1959] SCR 253; *Foley v Classique Coaches Ltd* [1933] 2 KB 1; *Mamidoil-Jetoil Greek Petroleum Co v Okta Crude Oil Refinery* [2001] 2 Lloyd's Rep 76; and *Summergreene v Parker* (1950) 80 CLR 304.

71 See *Film Bars Pty Ltd v Pacific Film Laboratories Pty Ltd* (1979) 1 BPR 9251, 9255.

72 [2001] FCA 1876 (Unreported, Weinberg J, 21 December 2001).

73 Ibid [263].

because in many cases these are drafted by the parties and not by their lawyers.

In *Coal Cliff Collieries v Sijehama Pty Ltd*[74] Kirby P, in concluding that a heads of agreement went beyond negotiations, was influenced by the opening terms of the agreement which provided for the '*full and binding effect of what is now agreed'*.[75] Similarly, the language used by the parties was decisive in *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd*[76] where Barrett J placed significant weight on the fact that the agreement stated that the Heads of Agreement was to be legally binding.[77] The language used by the parties might at times indicate that there was no intention to be bound. In *Carr v Brisbane City Council*[78] a variation clause in an agreement referred to the parties being 'prepared to negotiate'[79] and Mansfield SPJ concluded that the words clearly envisaged further negotiations between the parties and he therefore held that there was no contract between the parties.[80]

In both *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[81] and *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[82] the language used by the parties was closely examined by the respective courts. In *Anaconda Nickel Ltd v*

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74 (1991) 24 NSWLR 1.

75 Ibid 21 (Kirby P) (emphasis added by Kirby P).

76 (2002) 18 BCL 57. An appeal on other grounds was dismissed: see *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2003] NSWCA 74 (Unreported, Meagher, Hodgson JJA and Young CJ in Eq, 10 April 2003).

77 Ibid 61.

78 [1956] QSR 402.

79 Ibid 410.

80 Ibid 410–411.

81 (2000) 22 WAR 101. For a review of the case see, Mark Gerus, 'Heads of Agreement for Split Commodity Arrangement – Whether Too Uncertain or Incomplete for Contract' (2000) 19 *Australian Mining and Petroleum Law Journal* 12.

82 [2002] 2 NZLR 433. For a review of the case see, James Willis, 'Enforceability of Heads of Agreement, Intention to be Bound and Omission of Essential Terms' (2001) 20 *Australian Mining and Petroleum Law Journal* 312; and David McLauchlan, 'The FCE/ECNZ Heads of Agreement: Progress Report or Binding Contract?' (2002) 8 *New Zealand Business Law Quarterly* 192.

Tarmoola Australia Pty Ltd[83] the court had to decide whether a short written agreement was a binding contract. The respondent held various exploration and mining leases in Western Australia and the appellant was a nickel miner who wished to explore the tenements for nickel. The parties commenced negotiations in September 1994 and eventually signed a heads of agreement in April 1996. The heads of agreement had only five clauses. First, it provided that the appellant would make three payments to the respondent, totalling $250,000. Secondly, the appellant was required to expend $500,000 over three years to earn a 100 per cent interest in any base metals discovered. Thirdly, the respondent would retain a one per cent gross royalty on revenue from any base metals. Fourthly, the respondent would retain a 100 per cent interest in any precious metals discovered. Fifthly, that upon an area being identified as capable of sustaining mining of both precious and base metals, priority would be determined by the mineral with the greatest recoverable value. The heads of agreement concluded that the document 'forms a heads of agreement which constitutes an agreement in itself intended to be replaced by a fuller agreement not different in substance or form'. Ipp J, who referred to the document as the 'Letter Agreement', was clearly swayed by the language used by the parties when he concluded that there are 'powerful indications from the Letter Agreement that the parties intended that the document should be a legally binding contract'.[84]

In *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[85] the New Zealand Court of Appeal was called upon to decide whether a heads of agreement for the long-term supply of gas by the respondent to the appellant was a binding contract. In 1996 Fletcher Challenge Energy Ltd (Fletcher Challenge) had set its sights on acquiring a larger stake in the

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83 (2000) 22 WAR 101.

84 Ibid 114 (Ipp J).

85 [2002] 2 NZLR 433. See also David McLauchlan, 'The Legal Status of Heads of Agreement: Recent Developments' [2002] *AMPLA Yearbook* 518. For the decision at first instance see *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2001] 2 NZLR 219, 230. See also, James Willis, 'Fletcher Challenge Energy Limited v Electricity Corporation of New Zealand Limited' (2000) 19 *Australian Mining and Petroleum Law Journal* 267.

Kupe gas project in New Zealand and submitted a bid for the 40% interest owned by Western Mining Corporation (Western Mining). The Electricity Corporation of New Zealand Ltd (Electricity Corporation) also submitted a closely competing bid whereupon Western Mining decided to conduct a second bidding round with a 28 February 1997 deadline. The parties entered into discussions and an agreement was negotiated by telephone on 26 and 27 February 1997 between the two chief executives, Mr Fletcher of Fletcher Challenge and Mr Frow of the Electricity Corporation. A letter agreement recording the terms was signed. This came to be known as the 'Fletcher/Frow Letter' and provided that the Electricity Corporation and Fletcher Challenge would re-submit their previous bids for Western Mining's interest in Kupe and, if either was accepted, they would split the interest 25.75% to the Electricity Corporation and 14.25% to Fletcher Challenge. It further provided that the Electricity Corporation and Fletcher Challenge

> will enter into the Heads of Agreement for long term gas supply. This Heads of Agreement will specify all essential terms for it to be a binding agreement, including annual quantities, max/min flow rates, start date, duration, prices throughout, force majeure terms. This Heads of Agreement will be conditional on [the Electricity Corporation's] Board approval within eight days.

On 27 and 28 February 1997, senior officials of the companies met to negotiate the heads of agreement and lawyers were deliberately excluded. However, the major obstacle remained that the Electricity Corporation wanted to secure a firm gas supply through to 2017 whereas Fletcher Challenge was unwilling to commit itself beyond 2011. Eventually a compromise was reached whereby Fletcher Challenge was obliged to deliver beyond 2011 but only if delivery was economic. The heads of agreement also contained two conditions precedent. The first was that Fletcher Challenge and the Electricity Corporation secured the Western Mining interest in the Kupe gas field and the second was the Electricity Corporation's board approval. The parties also marked two items as 'Not Agreed' and the heads of agreement was duly signed during the afternoon of 28 February 1997. The heads of agreement was clearly completed under circumstances of some urgency. The majority concluded:

> We consider that it is very significant in a document which on its face appeared incomplete – where items were actually marked "not agreed" – that the negotiators did not record that

> their agreement was to be regarded as complete, or legally binding.[86]

They further concluded that the heads of agreement 'seems to us to be in the nature of a progress report from the negotiators'.[87] In contrast to the majority, Thomas J in dissent held that the heads of agreement contained 'language appropriate to an agreement intended to be binding'.[88] In expressing his agreement with the trial judge, Wild J,[89] Thomas J observed that there was

> no point in including conditions precedent if the parties did not intend the [heads of agreement] to bind them upon execution. A condition precedent was simply not necessary if either party was free to regard the [heads of agreement] as a step in the negotiating process or something in the nature of a progress report from the negotiators.[90]

It is submitted that the approach and conclusions of Thomas J are to be preferred. His approach is clearly intended to hold the parties to their bargain. The majority, however, were concerned not to impose a contract on the parties and were reluctant to find the requisite intention to be bound from the language used by the parties, in particular because of the use of the phrase 'Not Agreed'. It is submitted that the majority placed too much emphasis on these words and that when the whole document is examined, and other relevant factors such as subsequent conduct is considered, it is clear that the parties intended to be bound.

D. *Performance under the alleged contract*

Partial performance under an alleged contract has long been recognised as a vital factor indicating intention to be bound. *Munroe v Heubach*[91] involved a preliminary agreement to be

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86 Ibid 449 (Richardson P, Keith, Blanchard and McGrath JJ).

87 Ibid 450 (Richardson P, Keith, Blanchard and McGrath JJ).

88 *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433, 470 (Thomas J).

89 *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2001] 2 NZLR 219. For a review of the case at first instance see, James Willis, 'Fletcher Challenge Energy Limited v Electricity Corporation of New Zealand Limited' (2000) 19 *Australian Mining and Petroleum Law Journal* 267.

90 *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2002] 2 NZLR 433, 470 (Thomas J).

91 [1909] WLR 196.

replaced by a formal agreement. Before the preparation or execution of the formal agreement, the parties commenced to carry out the general terms already settled. Perdue JA held that in those circumstances 'what might have been a perfectly good defence by the purchaser so long as the contract was executory, became no longer available to him when there had been a substantial part performance of it'.[92] In *Sudbrook Trading Estate Ltd v Eggleton*[93] Templeman LJ provided a clear example of the importance the courts should place on this factor in appropriate circumstances. Templeman LJ said that where an agreement that might fail because of incompleteness, if it has been partly performed 'the court will strain to the utmost to supply the want of certainty'.[94] This is consistent with the decision in *Trentham Ltd v Archital Luxfer*[95] where Steyn LJ held that the fact that 'the transaction was performed on both sides will often make it unrealistic to argue that there was no intention to enter into legal relations'.[96]

In *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [97] there was no performance under the alleged contract and this was not an issue.[98] However, in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[99] it was a crucial factor. Ipp J addressed the issue of performance under the agreement and noted that the Letter Agreement had been implemented for some 16 months, $25,000 had been paid by the appellant, and the appellant had carried out exploration work in regard to base metals.[100] In relation to partial performance Ipp J concluded that 'the partial implementation of the Letter Agreement supports the

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92 Ibid 206 (Perdue JA). See also *Carter v Scargill* (1875) LR 10 QB 564; *Ellen v Topp* (1851) 155 ER 609; and *White v Beeton* (1861) 158 ER 385.

93 [1983] 1 AC 444.

94 Ibid 460 (Templeman LJ).

95 [1993] 1 Lloyd's Rep 25.

96 Ibid 27 (Steyn LJ).

97 [2002] 2 NZLR 433.

98 Subsequent conduct, other than performance under the contract, was relevant and this will be examined in the following section.

99 (2000) 22 WAR 101.

100 Ibid 116 (Ipp J).

appellant's contention that the document was intended to be a binding contract'.[101]

In *Maroubra Pty Ltd v Murchison Queen Pty Ltd*[102] a critical factor in Hasluck J's conclusion that a binding contract existed was the payment of an amount due under the agreement.[103] Similarly, in *Pacific Power & Elcom Collieries Pty Ltd v Cumnock No 1 Colliery Pty Ltd*[104] Bergin J concluded that there was a contract because coal was delivered and royalties were paid pursuant to the agreement.[105]

These decisions all support the proposition that partial performance of the agreement is a significant factor in identifying intention to be bound. It is submitted that it should be the next factor examined after examining the actual language used by the parties. It is extremely relevant because it provides some objective evidence of intention. A bystander looking at the language used by the parties and observing their performance of the agreement is likely to conclude that the parties must have intended to form a binding contract. If no contract had been formed there may be no rational explanation for their performance of obligations expressed in the agreement. It is therefore appropriate that courts place considerable weight on this factor where the language used by the parties is inconclusive.

E. *Subsequent conduct*

Subsequent conduct extends to conduct other than partial performance under the alleged contract and might include some activity in reliance on the agreement. In *Howard Smith & Co*

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[101] Ibid 118 (Ipp J).

[102] [2002] WASC 98 (Unreported, Hasluck J, 3 May 2002). For comment on the case see, David Allison and Mark Gerus, 'Intention to Create Legal Relations' (2002) 21 *Australian Mining and Petroleum Law Journal* 140.

[103] Ibid [36].

[104] [2001] NSWSC 1100 (Unreported, Bergin J, 30 November 2001). For a review of the case see, Lisa Ziegart, 'Binding Agreement – Royalty Variation – Guarantee' (2002) 21 *Australian Mining and Petroleum Law Journal* 6. An appeal was dismissed; see *Cumnock No 1 Colliery Pty Ltd v Pacific Power* [2002] NSWCA 278 (Unreported, Meagher, Handley JJA and Foster AJA, 4 September 2002).

[105] Ibid [118].

Ltd v Varawa[106] the parties had signed a preliminary agreement. Griffith CJ, referring to subsequent conduct of the parties, concluded that any statements or conduct on their part after they signed the agreement were relevant to determine whether the parties had formed a contract.[107] In *Rural Insurance (Aust) Pty Ltd v Reinsurance Australia Corp Ltd*[108] Einstein J placed considerable weight on the subsequent conduct of the parties and, in particular, emails sent after the time of the alleged contract requesting the defendant to confirm whether the "proposal" was acceptable.[109] Einstein J concluded that as the correspondence referred to the alleged contract as a proposal it was clearly not a contract.[110]

In *Re WG Apps & Sons Pty Ltd*[111] Barry J observed 'that the Courts have been anxious in commercial transactions to find the language of the parties constituted a valid contract where the conduct of the parties shows that they regarded themselves as bound in the course of dealings in a trade with the usages and customs with which they are familiar'.[112] In *R & J Dempster v Motherwell Bridge and Engineering Co*[113] Lord President Clyde found the subsequent conduct decisive when he observed that 'for more than a year after the bargain was made both parties acted on the basis that there was a binding agreement'.[114] He also noted that 'unenforceable arrangements are the exception and not the rule'.[115]

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106 (1907) 5 CLR 68.

107 Ibid 78. See also *Barrier Wharfs Ltd v W Scott Fell & Co Ltd* (1908) 5 CLR 647. See also Barbara McDonald and Jane Swanton, 'Subsequent Conduct as an Aid to Interpretation of a Contract – 'the Refuge of the Desperate"?' (1993) 67 *Australian Law Journal* 864.

108 (2002) 41 ACSR 30.

109 Ibid 42.

110 Ibid.

111 [1949] VLR 7.

112 Ibid 9. See also *Interway Inc v Alagna* 407 NE 2d 615 (1980); *Imperial Oil Ltd v Young* (1998) 167 Nfld & PEIR 280, 314; and *Terrex Resources NL v Magnet Petroleum Pty Ltd* (1988) 1 WAR 144.

113 [1964] SC 308.

114 Ibid 327 (Lord President Clyde).

115 Ibid 327–328 (Lord President Clyde).

These cases support the proposition that the conduct of the parties after the execution of the agreement can, at times, be a decisive matter. Despite general agreement that subsequent conduct can be considered there is disagreement about precisely *what* subsequent conduct is admissible as evidence, and if it is admissible what weight should be attached to it. In *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[116] there were a number of strong indications from the conduct of the parties that they had intended to be bound. These were noted by Thomas J. First, the CEO of the Electricity Corporation prepared a report to the board of directors of the Electricity Corporation, which stated that 'A heads of agreement for the gas contract was concluded following successful negotiation'.[117] Secondly, the Electricity Corporation's internal documentation in the months following the heads of agreement was notable for 'continuously referring to the [heads of agreement] as a contract'.[118] Thirdly, an Electricity Corporation internal memorandum referred to transforming 'the contractually binding [heads of agreement] into full contract terms'.[119] Fourthly, the Electricity Corporation included the heads of agreement in its 1997 Annual Report under the heading of long term contracts.[120] Fifthly, the Chairperson of the Electricity Corporation wrote the Minister of Finance in 1998 and referred to 'the legally binding Heads of Agreement'.[121]

The majority proceeded on the basis that such evidence was admissible but concluded that 'these types of material have proved to be contradictory and ultimately largely unhelpful'.[122] The majority held reservations about whether such evidence should be considered, preferring to limit the consideration to the 'subsequent conduct of the parties towards one another, including what they have said to each other after the date of the

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116 [2002] 2 NZLR 433.

117 Ibid 477 (Thomas J).

118 Ibid 478 (Thomas J).

119 Ibid 480 (Thomas J).

120 Ibid 482 (Thomas J).

121 Ibid 483 (Thomas J).

122 Ibid 445 (Richardson P, Keith, Blanchard and McGrath JJ).

alleged contract'.[123] In contrast to the majority in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*,[124] Thomas J concluded that these 'documents provide concrete evidence that [the heads of agreement] was intended and accepted by [the Electricity Corporation] that the [heads of agreement] was a binding agreement. It was the deal'.[125] Thomas J went on to conclude that the parties' conduct was 'inconsistent with any other interpretation'.[126]

This difference in approach highlights the question of whether the courts should look at all at the subjective intention of the parties. It may be that one or more of the parties had a subjective view that they had formed a contract when in fact at law no contract had been formed. This supports the decision of the majority to place less weight on this factor but at the same time it is easy to understand Thomas J's view that the parties did actually intend for the agreement to be binding. If subjective intention is ignored, or given little weight, then in some cases a court might conclude that there was no intention to be bound even where the evidence suggests a strong intention to be bound. This is likely to occur where the language used by the parties provides some difficulty, as was the case in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd.*[127] By placing little weight on the subjective intention of the parties the courts face potential criticism that they are not meeting the legitimate expectations of the parties because they are not holding people to their bargains. This creates a difficult issue and must be taken to be settled in New Zealand. However, it remains to be seen whether Australian courts might continue to place more weight on the subjective intention of the parties, as demonstrated by their subsequent conduct, at least in relation to the limited issue of preliminary agreements. The Australian decisions in *Howard Smith & Co Ltd v Varawa,*[128] *Re WG Apps*

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123 Ibid (Richardson P, Keith, Blanchard and McGrath JJ).

124 [2002] 2 NZLR 433.

125 Ibid 467 (Thomas J).

126 Ibid 483 (Thomas J). See also *Sanford v Senger* [1977] 3 WWR 399 at 403 where Walker DCJ held that when people 'present all the phenomena of agreement, they are not allowed to say that they were not agreed'.

127 [2002] 2 NZLR 433.

128 (1907) 5 CLR 68.

& Sons Pty Ltd[129] and *Rural Insurance (Aust) Pty Ltd v Reinsurance Australia Corp Ltd*[130] are consistent with the proposition, that in the limited context of preliminary agreements, it is appropriate to consider subsequent conduct.

It is important to note that the consideration of subsequent conduct in the context of preliminary agreements is a departure from the general rule that the subsequent conduct of the parties should not be considered in the contractual context. In *Schuler AG v Wickman Machine Tool Sales Ltd*[131] the House of Lords held that in general an agreement cannot be construed by reference to the subsequent conduct of the parties. The decision not to apply such a rule in the context of determining whether a preliminary agreement is a contract can be justified on the basis that the court is concerned to identify the intention of the parties in forming a contract rather than determining the meaning of a contractual term.

F. *Absence of essential terms and incompleteness*

There has been some difference in approach where there is the absence of an essential term. In *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[132] Ipp J held that if an essential term was missing 'inferences may be drawn that the parties lacked the requisite intention to contract'.[133] In *Terrex Resources NL v Magnet Petroleum Pty Ltd*[134] Kennedy J addressed the issue of essential terms and concluded that:

> An agreement does not have to be worked out in meticulous detail. A bargain can be made containing certain terms, regarded as essentials, whilst the parties recognise that a formal document will eventually be drawn up in the full expectation that a number of additional terms will, by consent, be included in that document.[135]

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[129] [1949] VLR 7.

[130] (2002) 41 ACSR 30.

[131] [1974] AC 235.

[132] (2000) 22 WAR 101.

[133] Ibid 110 (Ipp J).

[134] (1988) 1 WAR 144.

[135] Ibid 159 (Kennedy J).

In concluding that the agreement in question was not a contract the majority in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[136] did so on the basis of the failure to agree on terms the parties considered essential:

> [T]he "not agreed" items were of a kind which could not be expected to be settled for the parties by a Court or other third party … We consider that they were marked "not agreed" as an indication of their importance, and that they were regarded as essential terms. The [heads of agreement] accordingly seems to us to be in the nature of a progress report from the negotiators.[137]

On this basis the court held that there was no contract because the parties had not intended to be bound.

It is submitted that the lack of an essential term and incompleteness should be considered by courts but that this factor should be less important than the language used by the parties, performance under the alleged contract and subsequent conduct. Incompleteness should only be a decisive factor if a court is satisfied that the parties' intention cannot be determined from the three most important factors listed above.

G. *Characteristics of the transaction*

Courts take into account the specific characteristics of each transaction. These characteristics include the subject matter, size of the transaction and its complexity. This factor of characteristics does to some extent, overlap with incompleteness and the lack of an essential term because the characteristics of the transaction will indicate what terms the parties might consider to be essential or otherwise necessary to complete their bargain.

In *Toyota Motor Corp v Ken Morgan Motors*[138] Brooking J said that regard may be had 'to the magnitude of the transaction in considering how likely it is that the parties would have intended to make or record a binding contract by means of some informal, vague and relatively short document'.[139] The nature and

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[136] [2002] 2 NZLR 433.

[137] Ibid 450 (Richardson P, Keith, Blanchard and McGrath JJ).

[138] [1994] 2 VR 106.

[139] Ibid 131 (Brooking J).

formality of the document will thus be important. But in *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd*[140] McHugh JA stressed that the characteristics of a transaction cannot be allowed to override other more important considerations:

> If the terms of a document indicate that the parties intended to be bound immediately, effect must be given to that intention irrespective of the subject matter, magnitude or complexity of the transaction.[141]

It is submitted that although the size and complexity of the transaction is a valid factor for the courts to consider it should not be allowed to override other considerations unless the court is satisfied that the parties clearly did not intend to be bound.

H. *Arbitration clauses*

The existence of an arbitration clause can be of great assistance to a court, particularly where a court might be reluctant to find the relevant intention to be bound where there is alleged incompleteness. Considerations regarding the importance of an arbitration clause therefore overlap to some extent with the consideration of incompleteness. In addition, the presence or absence of an arbitration clause is also a valid factor for a court to consider when addressing the second part of the two-stage test of whether a contract exists. This will be discussed further in part three.

The presence of an arbitration clause might indicate that the parties have considered that disagreement could arise in the future and they have provided a means for resolving such disputes. In *Summergreene v Parker*[142] the High Court considered the existence of an arbitration clause in the agreement in question and Latham CJ held that the parties to a contract 'may bind themselves under a contract which is complete in itself

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[140] (1986) 40 NSWLR 631.

[141] Ibid 634 (McHugh JA). See also *Seven Cable Television Pty Ltd v Telstra Corporation* (2000) 171 ALR 89; and *Texaco Inc v Pennzoil Co* 729 SW 2d 768 (Tex App – Houston [1st Dist] 1987).

[142] (1950) 80 CLR 304.

to leave specified matters to be determined by a third party, e.g. by an … arbitrator'.[143]

In *Calvan Consolidated Oil & Gas Co Ltd v Manning*[144] the Supreme Court of Canada considered an oil and gas joint venture agreement which was preliminary in nature and held that the parties had

> expressed their intention with precision and a commendable economy in the use of words. In an agreement of this kind, where the lands may be first of all sold or made subject to a farmout agreement, it seems to me virtually impossible for the parties at that stage of the proceedings to set out in full what the terms of operation would be if Calvan were to develop the land itself … There is every reason, therefore, why the parties here introduced an arbitration clause into their agreement to deal with this particular point.[145]

The court clearly acknowledged that parties might not be able to agree on all necessary or desired terms at a particular time. In such cases the presence of a workable arbitration clause will make it possible for the courts to meet the expectations of the parties and hold that the preliminary agreement to be binding.

The approach of the courts is consistent in that arbitration clauses will be seen as of some assistance to the court. However, they should not be considered a decisive factor.

IV. PART THREE – INCOMPLETENESS AND UNCERTAINTY

A. *The traditional approach*

It is often stated that it is a 'fundamental principle of law that the court will not make a contract for the parties'[146] and this reflects the traditional approach of the courts. In *May & Butcher Ltd v*

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[143] Ibid 316 (Latham CJ).

[144] [1959] SCR 253.

[145] Ibid 259.

[146] Kenneth Sutton, 'The Uncertainty of Certainty of Contract' (1981) 5 *Otago Law Review* 11, 11.

The King[147] the House of Lords refused to find a binding contract despite the parties clearly intending to be bound by the actual language they used.[148] The price was left to be agreed in the future and the wording of the arbitration clause did not allow the court to imply a reasonable price.[149] Accordingly, the House of Lords held the agreement to be incomplete on the grounds that an essential term, price, was not specified and therefore at law there was no contract.[150]

Since the decision in *May & Butcher Ltd v The King*[151] there has been some controversy[152] as to whether contracts which omit essential terms can be considered sufficiently complete to be held binding. Ellinghaus[153] is critical of *May & Butcher Ltd v The King*[154] noting that even when the case was decided there was a strong tradition in the insurance industry to uphold the validity of future agreement on an essential term.[155]

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147 [1934] 2 KB 17 n. For contemporary comment on the case see, R S T Chorley, 'Notes' (1933) 49 *Law Quarterly Review* 316; and H C Gutteridge, 'Notes' (1932) 48 *Law Quarterly Review* 4. See also D M Gordon, 'Contracts – Certainty – Contract to Make a Contract' (1939) 17 *Canadian Bar Review* 205.

148 The parties themselves referred to 'this extended contract' – see *May & Butcher Ltd v The King* [1934] 2 KB 17n, 17.

149 *May & Butcher Ltd v The King* [1934] 2 KB 17n, 21 (Lord Buckmaster); 22 (Viscount Dunedin); and 22 (Lord Warrington).

150 Ibid 20 (Lord Buckmaster); 21 (Viscount Dunedin); and 22 (Lord Warrington).

151 [1934] 2 KB 17n.

152 See Ellinghaus, above n 41, 1. See also David McLauchlan, 'Rethinking Agreements to Agree' (1998) 18 *New Zealand Universities Law Review* 77; and R A Samek, 'The Requirement of Certainty of Terms in the Formation of Contract' (1970) 48 *Canadian Bar Review* 203.

153 See Ellinghaus, above n 41, 11. See also M P Ellinghaus, 'Uncertainty of Contract: Some Recent Developments' (1972) 4 *Adelaide Law Review* 365 where Ellinghaus also criticises the decision in *May & Butcher v The King* [1934] 2 KB 17n.

154 [1934] 2 KB 17n.

155 Ellinghaus, above n 41, 11.

B. *The modern approach*

There has clearly been a modern trend for courts to fill the gaps in agreements, including price, in appropriate circumstances.[156] This approach involves the court looking at incompleteness in a more constructive manner. Ayres and Gertner[157] argue that whether courts should fill gaps in agreements depends upon why the gap was left in the agreement.[158] Baird[159] argues that if parties do not include the necessary background rules then 'the law of contract must do it for them'.[160] Howard[161] argues that if the parties intended to be bound and the court fills gaps in the agreement then 'the court is not making a contract for the parties but merely enabling them to carry out their own intentions'.[162]

When addressing the issue of incompleteness a court does not restrict itself to the task of finding incompleteness in the form of a missing essential term and then concluding there is no contract. Rather, a court looks beyond the incompleteness and takes into account whether there has been any performance under the alleged contract and whether the parties have provided an arbitration clause or some other method of filling the gaps. In addition the court will consider any methods it has available to fill the gaps such as the implication of terms.

This approach started shortly after *May & Butcher Ltd v The King*[163] but has developed more rapidly in recent decades. Three years after *May & Butcher Ltd v The King*[164] the House of Lords

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156 See, eg, Murray Gleeson, 'Contractual Uncertainty' (1985) 1 *Australian Bar Review* 74.

157 Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 *Yale Law Journal* 87.

158 Ibid 127.

159 Douglas Baird, 'Self-Interest and Cooperation in Long-Term Contracts' (1990) 19 *Journal of Legal Studies* 583.

160 Ibid 586.

161 Michael Howard, 'Contracts – Sale of Goods – Problems of "Uncertainty" ' (1973) 51 *Canadian Bar Review* 668.

162 Ibid 675. See also Michael Howard, 'Problems of Indefiniteness in the Formation of Contracts for the Sale of Goods' (1974) 4 *University of Tasmania Law Review* 258.

163 [1934] 2 KB 17n.

164 Ibid.

decided *Hillas & Co Ltd v Arcos Ltd*[165] where a preliminary agreement was held to be binding. All of the judges in *Hillas & Co Ltd v Arcos Ltd*[166] stressed that the agreement was a commercial one which was plainly intended to be binding and that in such circumstances the task of the Court is, if at all possible, to give effect to that intention and where necessary making reasonable implications to fill gaps in the agreement.[167] It is submitted that this is very sound reasoning and reflects a similar approach adopted by Ipp J in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd.*[168]

In *Foley v Classique Coaches Ltd*[169] a number of factors were relevant in the court holding that the agreement was a complete contract including the plain intention of the parties to make a binding contract[170] and the subsequent conduct of the parties, in particular, performance of the contract over several years.[171] It is submitted that this performance under the contract was the decisive factor that led the court to find a binding contract and proceed to fill the gaps in the agreement.

In *Woodside Offshore Petroleum Pty Ltd v Atwood Oceanics Inc*[172] Kennedy J acknowledged the existence of a more modern position when he said it 'may readily be accepted that, since the 19th century, courts have taken a more lenient view to questions of uncertainty than previously'.[173] In *Cudgen Rutile (No 2) Pty Ltd v Chalk*[174] the Privy Council held that 'in modern times, the

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165 (1932) All ER 494. See also Fridman GHL, 'Construing, Without Constructing, a Contract' (1960) 76 *Law Quarterly Review* 521.

166 Ibid.

167 Ibid. This position has been followed in the Australian cases of *Upper Hunter County Council v Australian Chilling & Freezing Co Ltd* (1968) 118 CLR 429; and *Palmer v Bank of New South Wales* [1973] 2 NSWLR 244, both cases approving Lord Wright's position in *Hillas & Co Ltd v Arcos Ltd* [1932] All ER 494.

168 (2000) 22 WAR 101.

169 [1934] 2 KB 1. For contemporary comment on the case see, R S T Chorley, 'Notes' (1935) 51 *Law Quarterly Review* 277.

170 Ibid 8 (Scrutton LJ).

171 Ibid.

172 [1986] WAR 253.

173 Ibid 273 (Kennedy J).

174 [1975] AC 520.

courts are readier to find an obligation which can be enforced'.[175] This is consistent with the position adopted in *SVI Systems Pty Ltd v Best & Less Pty Ltd*[176] where Einfeld J held that where a contract which is prima facie incomplete has been largely performed 'the agreement may be upheld by the implication of terms in order to avoid the injustice to a party who has performed but was unable to enforce the contract'.[177]

In *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[178] the preliminary agreement was allegedly incomplete or uncertain in many respects including the following which were outlined by Ipp J. The agreement did not deal with the respective rights to title in the tenements; it did not stipulate who would have control over exploration; it made no provision for the responsibility for statutory expenditure required to be outlaid in regard to the tenements; it made no provision for dealing with native title claims; and it did not contain provisions that would enable disputes to be resolved.[179] Ipp J addressed each of these areas of incompleteness and uncertainty and concluded that:

> [T]he failure to enter into a more detailed agreement may make the exploring and mining operations contemplated by the Letter Agreement more expensive, difficult and complex, and may cause delays. But I do not accept that it is "unworkable" in the sense of it being objectively impossible for performance of its terms to be effected (and, in my view, that is the only relevant sense for the purposes of determining whether the Letter Agreement is a contract binding in law).[180]

As outlined earlier, the majority in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[181] held that the parties had not intended to be bound by the heads of agreement and accordingly they were not required to address the issue of

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[175] Ibid 536. See also *F & G Sykes (Wessex) Ltd v Fine Fare Ltd* [1967] 1 Lloyd's Rep 53.

[176] (2001) 187 ALR 302.

[177] Ibid 319–320.

[178] (2000) 22 WAR 101.

[179] Ibid 120 (Ipp J).

[180] Ibid 127 (Ipp J).

[181] [2002] 2 NZLR 433.

incompleteness and uncertainty to resolve the appeal. However, as there was a possibility of a further appeal to the Privy Council, the majority took time to consider whether the gaps in the agreement could be filled if they were wrong on the issue of intention to be bound. On the four alleged gaps in the agreement the court concluded that none of the gaps would be fatal to a complete agreement.[182] In relation to the lack of agreement on a force majeure clause the majority concluded that it was not essential as a matter of law.[183]

In relation to pre-paid gas relief the majority concluded, 'the agreement could operate without it'.[184] In relation to a missing component, to be used in an agreed formula, the majority agreed with the trial judge that it 'was capable of being assessed objectively if and when it was needed'.[185] In relation to a clause covering other liabilities the majority concluded that it was not 'essential as a matter of law'.[186]

Most recently in *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd*[187] Young CJ in Eq noted that 'the court will not go to unacceptable lengths to do what, in truth, the parties should have done for themselves'.[188] In determining the correct approach for the courts to adopt in attempting to fill the gaps left by the parties, Young CJ in Eq suggested that 'the court should examine one-by-one each missing term said to be essential to determine whether there needs to be further agreement between the parties or whether those terms are capable of being found by machinery or implication'.[189] Young CJ in Eq was clear in rejecting the approach taken at first instance by Brownie AJ in *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd.*[190] Brownie AJ concluded that when all the alleged missing terms were considered together the parties should not be regarded as having created a binding

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182 Ibid 453 (Richardson P, Keith, Blanchard and McGrath JJ).

183 Ibid (Richardson P, Keith, Blanchard and McGrath JJ).

184 Ibid (Richardson P, Keith, Blanchard and McGrath JJ).

185 Ibid 454 (Richardson P, Keith, Blanchard and McGrath JJ).

186 Ibid (Richardson P, Keith, Blanchard and McGrath JJ).

187 (2005) 12 BPR 23,021.

188 Ibid at 23,033.

189 Ibid at 23,035.

190 [2004] NSWSC 271 (Unreported, Brownie AJ, 14 April 2004).

contract because there 'was just too much still to be worked out'.[191] Young CJ in Eq held that this 'in toto approach' in relation to the question of completeness was inappropriate.[192]

There is therefore a modern trend to fill gaps in incomplete agreements.[193] As Allars[194] observes, the decision in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[195] shows that the courts are loath to hold a contract void for uncertainty and the courts will go to extraordinary lengths to complete the terms of an agreement for the parties.[196]

C. *Limits of the modern approach*

But courts will not fill in all the gaps in incomplete agreements. In *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd*[197] Kirby P noted the difficulty facing courts when there are major gaps in agreements:

> Courts are not well equipped, drawing on their own experience, to fill out the detail of such contracts where the parties leave gaps in their own agreement … Courts cannot enforce such agreements because they are incapable of judging where the negotiation on particular points would have taken the parties.[198]

In *Trawl Industries of Australia Pty Ltd v Effem Foods Pty Ltd*[199] Kirby P held that a commercial agreement which provided that the price, to be calculated to give a 'reasonable commercial

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191 Ibid [49].

192 *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd* (2005) 12 BPR 23,021 at 23,035.

193 See also *Canada Square Corp Ltd v Versafood Services Ltd* (1982) 130 DLR (3d) 205; *Mamidoil-Jetoil Greek Petroleum Co v Okta Crude Oil Refinery* [2001] 2 Lloyd's Rep 76; and *Imperial Oil Ltd v Young* (1998) 167 Nfld & PEIR 280.

194 Vicky Allars, 'Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd – The Extraordinary Lengths the Courts Will go to in Order to Bind Parties to their "Agreement" '(2000) 2 *University of Notre Dame Australia Law Review* 71.

195 (2000) 22 WAR 101.

196 Allars, above n 194, 71.

197 (1991) 24 NSWLR 1.

198 Ibid 20.

199 (1992) 27 NSWLR 326.

profit' to the appellant, was illusory.[200] In *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[201] the majority concluded that:

> It will be a matter of fact and degree in each case whether the gap left by the parties is simply too wide to be filled. The Court can supplement, enlarge or clarify the express terms but it cannot properly engage in an exercise of effectively making the contract for the parties … Gaps can be filled by implication, but only if there is such a skeleton of express terms combined with an intention to contract.[202]

These recent cases provide three differently worded tests or approaches in relation to incompleteness. First, the 'skeleton of express terms' approach adopted by the majority in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd.*[203] Secondly, the 'unworkable test' utilised by Ipp J in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd.* [204] Finally, the gap by gap approach adopted by Young CJ in Eq in *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd.*[205] It is submitted that the appropriate starting point is to identify whether there is a skeleton of express terms. If such a skeleton of terms is not present a court is likely to conclude on the first part of the two-stage inquiry that the parties did not intend to be bound. Once the court is considering the issue of completeness as a separate inquiry the focus is on the gaps in the agreement. It is then that both the approach of Ipp J in *Anaconda* and of Young CJ in Eq in *Helmos* have a role to play. The first task should be to adopt the approach of Ipp J and determine whether the agreement is workable without any additional terms. If it is workable then the agreement passes the completeness test and is a contract. The parties can then argue for implied terms in the usual way. But critically the agreement would constitute a contract based solely on its express terms. The approach of Young CJ in Eq becomes

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200 Ibid 334 (Kirby P). See also John Gava, 'The Perils of Judicial Activism: the Contracts Jurisprudence of Justice Michael Kirby' (1999) 15 *Journal of Contract Law* 156, 168.

201 [2002] 2 NZLR 433.

202 Ibid 447 (Richardson P, Keith, Blanchard and McGrath JJ).

203 [2002] 2 NZLR 433.

204 (2000) 22 WAR 101.

205 (2005) 12 BPR 23,021.

necessary if the agreement has gaps such that the express terms are not sufficient to pass the completeness test. Implied terms, or some other mechanism, will be required to conclude that a contract has been formed. The approach adopted by Young CJ in Eq has the attraction that each alleged gap is treated on a case by case basis. If each alleged gap can be overcome by the implication of a term or some other mechanism then the parties have formed a contract.

It is submitted therefore that the three approaches are not mutually exclusive. They each have a role to play in the overall process of determining whether the parties have formed a contract although the skeleton of express terms approach is of most relevance to the issue of whether the parties had an intention to form a contract. When the exercise is focused on filling the gaps both the approach of Ipp J and of Young JA have a role to play. Ipp J's approach answers the question as to whether the gaps need to be filled at all and Young CJ in Eq's approach deals with how the gaps might be filled.

Allars[206] is critical of the majority's decision in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[207] on the basis that the preliminary agreement failed to address a number of vital issues and the result of the decision is that parties will be bound by the limited terms they have agreed, supplemented by additional terms imposed by the court, which may be terms to which they would never have agreed.[208] This criticism reflects a reluctance to reject the traditional approach. However, as outlined in the passages extracted above courts in Australia, England, New Zealand and Canada have for some considerable time rejected the traditional approach. These courts now consistently fill gaps in agreements when they are satisfied that it was the intention of the parties to have a binding contract.

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[206] Allars, above n 194.

[207] (2000) 22 WAR 101.

[208] Allars, above n 194, 75–76.

V. CONCLUSION

The Courts are correct to adopt a two-stage test in determining whether a contract exists between the parties. In addressing the first stage of the test, whether the parties intended to be bound, courts look at a wide range of factors. It has been argued that courts should place most weight on the language used by the parties. If the language used is not decisive then the courts should look for evidence of any acts of performance and closely examine the subsequent conduct of the parties. To a large extent this is the approach of the Australian courts and is reflected in the approach taken in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd.*[209]

In contrast the Court of Appeal in New Zealand, although placing considerable weight on the language used by the parties, placed more weight on alleged incompleteness and the characteristics of the transaction than Australian courts have done. In addition the Court of Appeal in New Zealand considered that evidence of the subsequent conduct of the parties should only be considered if it relates to conduct and correspondence between the parties. It has been argued in this paper that such an approach is too narrow. In some circumstances subsequent conduct might at times provide critical evidence of the intent of that party and that, in the limited context of preliminary agreements, it is appropriate to consider all subsequent conduct.

In deciding the second part of the two-stage approach, whether the agreement is complete enough to be a contract, it is submitted that the modern approach, of going to considerable lengths to fill gaps in agreements, has now been accepted by the courts. If the express terms are unworkable then the courts should examine each gap independently and determine if that gap can be filled.

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[209] (2000) 22 WAR 101.

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