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The Legal Status of Heads of Agreement: Recent Developments

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SUMMARY

This paper discusses recent developments concerning the enforceability of heads of agreement. It focuses on the two main issues that are likely to arise when a party repudiates a heads of agreement and the other party seeks a remedy for breach of contract: first, was the agreement intended to be legally binding and, secondly, is the agreement sufficiently complete and certain to be enforceable? The author argues that the doctrines of the classical law of contract that sometimes prevented enforcement of preliminary agreements no longer exert the influence that they once did and that the courts are now better placed to reach commercially sensible solutions that reflect the reasonable expectations of the parties. He points, in particular, to the recent recognition by the Australian courts of the principle that there may be a valid contract where parties reach agreement on a limited number of terms which they regard as essential and they defer other matters for future agreement between them.

The latter part of the paper discusses the important and contentious recent decision of the New Zealand Court of Appeal in Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd. The statements of legal principle by the Court of Appeal in the course of its judgment are consistent with, and in some respects overtly more liberal than, the approach reflected in the recent Australian cases, but the author questions the correctness of the actual decision that the heads of agreement in question was not intended to be legally binding. The paper concludes by suggesting some lessons to be learned from the recent case law.

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INTRODUCTION

In the course of his closely reasoned and instructive dissenting judgment in the recent New Zealand case of *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*,[1] Thomas J spoke at length about the important function of heads of agreement in the world of commerce. He described their use as "a valuable and essential commercial tool"[2] which the courts should strive to facilitate bearing in mind that one of the fundamental purposes of the law of contract is "to give effect to the reasonable expectations of commercial men and women by giving legal effect to their bargains".[3] Although Thomas J was in the minority there is little in the judgment of the four majority judges[4] to indicate that they disagreed with his Honour's general sentiments in this respect. The disagreement was over whether the particular, and somewhat unusual, document before the court was intended to be binding. More importantly, my hunch is that those in the commercial world who are familiar with heads of agreement would empathise with most of Thomas J's views, so much so that the following passage in his judgment merits quotation in full:[5]

> "Heads of agreement are an integral part of commercial activity. They, and the regularity with which business men and women resort to them, are a commercial reality. Sometimes they are complete. More often than not, however, they leave matters to be decided later. As Lord Lloyd (then Lloyd LJ), who was for a time an important distinguished Judge of the Commercial Court in the United Kingdom has stated, parties may agree to be bound now while deferring important matters to be agreed later. 'It happens,' he said, 'every day when parties enter into so-called "heads of agreement" '. See *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601, at p 619.
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> Experience indicates why heads of agreement are an essential feature of commercial activity. Commercial agreements are frequently complex documents, but what is crucial is the essence of the bargain. Doing the initial deal or bargain is the task of senior managers. They are the deal-makers. Often the circumstances require the bargain to be 'struck under great pressure of events and time' (Johan Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 LQR 433, at p 439). Heads of agreement suffice to complete a binding transaction. The managers, the deal-makers, then move

1 [2002] 2 NZLR 433 (CA).
2 Ibid at 465 (para 135).
3 Ibid at 462 (para 128).
4 Richardson P, Keith, Blanchard and McGrath JJ.
5 [2002] 2 NZLR 433 at 463-464 (paras 130-133).

to other productive areas of the company's business, leaving the core agreement to be expanded into a comprehensive document by subordinate executives and the parties' legal advisers.

Naturally, the chief executives or deal makers will focus on the essential elements of a proposed agreement. Contingencies will frequently be incompletely dealt with in that the contract will fail to specify a party's obligation on the occurrence of a future contingency or fail to address a future contingency at all. (See David Goddard, 'Long-Term Contracts: A Law and Economics Perspective' (1997) NZ Law Rev 423, at 426). Provisions to cover [contingencies] deal with the allocation of risk and, if no explicit provision is agreed, the parties accept the risk involved. By and large essential terms do not relate to contingencies. There are various reasons why this is so: by definition, the contingency may be a remote possibility and may never occur; the sensible outcome, should the contingency occur, may be able to be determined by agreement or, failing agreement, by resorting to the common law; the appropriate provision may be a 'boiler plate' clause or one that can readily be determined by reference to industry practice; or the parties may simply not be prepared to risk jeopardising a favourable bargain, the essential elements of which have been agreed, by arguing about a contingency which is remote and may never occur. Thus, it is not uncommon for commercial parties to enter into heads of agreement which have gaps, but which are intended to be binding pending the completion of a more comprehensive agreement. Where the heads of agreement are not intended to be binding, but only the forerunner to a formal contract, commercial prudence (if not the sense of self-preservation of the executives carrying out the negotiation) will ordinarily dictate that this conditional status be clearly spelt out.

There is nothing novel in this perception. Take, for example, Lord Wright's speech in *Hillas & Co Ltd v Arcos Ltd* [(1932) 147 LT 503]. The learned law Lord affirmed … that '[b]usiness men often record the most important agreements in crude and summary fashion', and … that 'in contracts for future performance over a period, the parties may neither be able nor may they desire to specify many matters of detail, but leave them to be adjusted in the working out of the contract.' Thus, the notion that the adversarial ethic prevails in commercial negotiations relating to a prospective deal is misconceived. Indeed, in the context of a prospective deal it is a myth. More often than not business men and women approach such negotiations with a 'win/win' objective and outlook. A bargain can be struck which, certainly overall and notwithstanding the

> inevitable and unresolved risks involved, will be perceived to be advantageous to both parties."

OBSTACLES TO ENFORCEMENT

In this passage Thomas J refers to the two main issues that are likely to arise when a party repudiates a heads of agreement (HoA) and the other party seeks a remedy, usually damages, for breach of contract. First, was the HoA intended to be legally binding on the parties pending execution of the anticipated formal written contract? Secondly, is the agreement sufficiently complete and certain to be enforceable? These issues have caused great difficulties for the courts, in large measure because they have been hamstrung by formalistic doctrines and rules of classical contract law. There is no better example than the general rule that an "agreement to agree" is void for incompleteness. Some courts continue to cite as elementary law the following passage from the speech of Viscount Dunedin *May & Butcher Ltd v The King*:[6]

> "To be a good contract there must be a concluded bargain, and a concluded contract is one which settles everything that is necessary to be settled and leaves nothing to be settled by agreement between the parties. Of course it may leave something which still has to be determined, but then that determination must be a determination which does not depend upon the agreement between the parties … As a matter of the general law of contract all the essentials have to be settled."

In my view,[7] this rule is not fit for survival in a modern commercial world where parties routinely enter into the likes of long-term relational contracts that require ongoing consultation and agreement between them. It was the product of a judicial mindset, typical of the so-called "classical" age of contract law, whereby contract liability was to be restricted as narrowly as possible. In the present context this meant that parties could only expect the imprimatur of "contract" to be stamped on their dealings if they had reached agreement on all material terms, and, since it would be unthinkable for a court to "make a contract" for the parties, there was "an aversion to the practical difficulties involved in supplying a term when the parties had failed to agree".[8]

[6] (1929) [1934] 2 KB 17n, 21.

[7] See D W McLauchlan, "Rethinking Agreements to Agree" (1998) 18 NZULR 77 and "Some Further Thoughts on Agreements to Agree" (2001) 7 NZBLQ 156.

[8] Richard E Speidel, "*Restatement Second:* Omitted Terms and Contract Method" (1982) 67 Cornell L Rev 785 at 788.

However, as I propose to demonstrate, there are encouraging signs that some of the classical doctrines are on the wane and that in future the courts will be better equipped to reach commercially sensible solutions that reflect the reasonable expectations of the parties.

Intention to be Bound

The issues of intention and incompleteness/uncertainty, although separate, are interrelated. Thus, the fact that a term or terms have been deferred for future agreement may be a factor indicating that the parties did not intend to be bound. As Gleeson CJ pointed out in *Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd*:[9]

> "To say that parties to negotiations have agreed upon sufficient matters to produce the consequence that, perhaps by reference to implied terms or by resort to considerations of reasonableness, a court will treat their consensus as sufficiently comprehensive to be legally binding, is not the same thing as to say that a court will decide that they intended to make a concluded bargain. Nevertheless, in the ordinary case, as a matter of fact and commonsense, other things being equal, the more numerous and significant the areas in respect of which the parties have failed to reach agreement, the slower a court will be to conclude that they had the requisite contractual intention."

The issues are also interrelated in the sense that, once intention to be bound *is* established, the court will do its best to give effect to that intention, notwithstanding apparent incompleteness or uncertainty.[10]

In the case of preliminary agreements, such as the HoA, where the parties contemplate that there will be a later more comprehensive and formal contract, the general principle is that the parties will be bound if, applying the usual objective test of intention for contract formation, it is reasonable to infer that they intended to be bound immediately and regarded the later document as merely giving more formal

[9] (1988) 18 NSWLR 540 at 548. See also *Toyota Motor Corporation Australia Ltd v Ken Morgan Motors Pty Ltd* [1994] 2 VR 106 at 130-131 per Brooking J ("It is well accepted that … the leaving of questions to be settled by subsequent agreement may suggest that there is no intention to make an immediately binding contract.") and 202 per JD Phillips J; and *Vroon BV v Foster's Brewing Group Ltd* [1994] 2 VR 32 at 77. But see the interesting situation in *Ampol Ltd v Caltex Oil (Australia) Pty Ltd* (1986) 60 ALJR 225 where the reservation of particular topics for separate negotiation was seen as "implying that the other provisions in the agreement are intended to be binding" (at 233 per Wilson J).

[10] See, eg, *York Air Conditioning and Refrigeration (Australasia) Pty Ltd v Commonwealth* (1949) 80 CLR 11 at 26; *Attorney-General v Barker Bros Ltd* [1976] 2 NZLR 495 at 498; *Money v Ven-Lu-Ree Ltd* [1988] 2 NZLR 414 at 417, 420, and 423;*Toyota Motor Corporation Australia Ltd v Ken Morgan Motors Pty Ltd* [1994] 2 VR 106 at 130 and 201; *Barrett v IBC International Ltd* [1995] 3 NZLR 170 at 173.

expression to their mutual commitments. They will not be bound if it is reasonable to infer that execution of the later formal document was regarded as the decisive step, that no binding obligations were intended until formalities were completed. It is well established that, even if the parties expressly state that a formal agreement shall be prepared, the former inference that the parties intended to make an immediately binding agreement may be open.[11]

In *Masters v Cameron*[12] the High Court of Australia, in a well known and often cited passage, distinguished between three classes of case. The court (Dixon CJ, McTiernan and Kitto JJ) said:[13]

> "Where parties who have been in negotiation reach agreement upon terms of a contractual nature and also agree that the matter of their negotiation shall be dealt with by a formal contract, the case may belong to any of three classes. It may be one 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. Or, secondly, it may be a case 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. Or, thirdly, the case may be one in which the intention of the parties is not to make a concluded bargain at all, unless and until they execute a formal contract.
>
> In each of the first two cases there is a binding contract: in the first case a contract binding the parties at once to perform the agreed terms whether the contemplated formal document comes into existence or not, and to join (if they have so agreed) in settling and executing the formal document; and in the second case a contract binding the parties to join in bringing the formal contract into existence and then to carry it into execution. Of these two cases the first is the more common . . .
>
> Cases of the third class are fundamentally different. They are cases in which the terms of agreement are not intended to have, and therefore do not have, any binding effect of their own … The parties may have so provided either because they have dealt only with major matters and contemplate that others will or may be regulated by provisions to be introduced into the

[11] See, eg, *Rossiter v Miller* (1878) 3 App Cas 1124 at 1151; *Masters v Cameron* (1954) 91 CLR 353 at 360-361; *Walmsley v Christchurch City Council* [1990] 1 NZLR 199 at 205.

[12] (1954) 91 CLR 353.

[13] Ibid at 360-361.

> formal document … or simply because they wish to reserve to themselves a right to withdraw at any time until the formal document is signed."

The significant feature of this passage for present purposes is that it suggests that there cannot be a binding contract within the first two categories unless "the parties have reached finality in arranging all the terms of their bargain". A similar view is to be found in a number of the other leading cases. Thus, in *Rossiter v Miller*[14] Lord O'Hagan, whilst holding that the express provision for a formal agreement did not prevent formation of an immediately binding contract, observed that "undoubtedly, if any prospective contract, involving the possibility of new terms, or the modification of those already discussed, remains to be adopted, matters must be taken to be still in a train of negotiation, and a dissatisfied party may refuse to proceed".[15] More recently, the High Court of Australia in *Godecke v Kirwan*[16] qualified *Masters v Cameron* by holding that the court in that case did not intend to exclude from the categories of binding contract "every case in which the formal document, when executed, would include terms additional to those already expressed",[17] but then added "provided that the additional terms did not depend on further agreement between the parties".[18]

However, there is also substantial authority for the less restrictive view that a preliminary agreement may be immediately binding notwithstanding that the parties anticipate that the later formal document will contain additional terms. This view has its origins in the speech of Lord Loreburn in *Love and Stewart Ltd v S Instone and Co Ltd*.[19] His Lordship said:[20]

> "It [is] quite lawful to make a bargain containing certain terms which one [is] content with, dealing with what one regard[s] as essentials, and at the same time to say that one [will] have a formal document drawn up with the full expectation that one [will] by consent insert in it a number of further terms."

[14] (1878) 3 App Cas 1124.

[15] Ibid at 1149. See also Lord Blackburn at 1151.

[16] (1973) 129 CLR 629.

[17] In *Godecke,* terms that the vendor's solicitor might reasonably require.

[18] (1973) 129 CLR 629 at 648 per Gibbs J. Further, Walsh J (with whom Mason J agreed) endorsed the analysis of the law by Bray CJ in *Powell v Jones* [1968] SASR 394, where his Honour referred (at 397) to the following as one category of case where there would be no binding contract: "The parties may have only agreed to agree. They may have left terms to be fixed by subsequent negotiation between them, their intention being that the provisions already agreed and those yet to be agreed shall operate together as one contract."

[19] (1917) 33 TLR 475.

[20] Ibid at 476.

This view has since been endorsed by numerous courts,[21] including the High Court of Australia prior to its decisions in *Masters v Cameron* and *Godecke v Kirwan*.[22] Indeed, it has prompted some Australian State courts in recent times to suggest that there is now a fourth category of case additional to the three mentioned in *Masters v Cameron*.[23] In the recent case of *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*[24] Ipp J, speaking for the majority of the Supreme Court of Western Australia, summarised this development as follows:

> "It is well recognised that parties may enter into a valid contract containing a limited number of terms comprising those terms essential to the bargain that they wish to conclude, in the expectation that at a later date a further contract will be arrived at containing additional terms that would facilitate and clarify the initial contract. That is to say, a binding contract may be arrived at even though it leaves unresolved many matters which might arise in future."

In my view, this is a sensible and logical development. It makes little sense to deny enforcement of a preliminary agreement that is intended to be legally binding simply because the parties expressly state their expectation that the proposed formal contract will contain additional terms. If a "HoA", which impliedly acknowledges the need for additional terms in a more formal contract, can be legally binding, why should it make a difference that the acknowledgement is express? The critical issue is whether the parties intended to make binding commitments on the terms that were agreed. If the answer is yes, the

[21] See, eg, *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601 at 619; *Baulkham Hills Private Hospital Pty Ltd v G R Securities Pty Ltd* (1986) 40 NSWLR 622 at 628; *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd* (1986) 40 NSWLR 631 at 634; *Terrex Resources NL v Magnet Petroleum Pty Ltd* (1988) 1 WAR 144 at 159; *Tern Minerals NL v Kalbara Mining NL* (1990) 3 WAR 486 at 495; *Vroon BV v Foster's Brewing Group Ltd* [1994] 2 VR 32 at 71; *Brunninghausen v Glavanics* (1999) 46 NSWLR 538 at 545; *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101 at 110; and *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886 (para 24), (2002) 18 BCL 57 at 61-62. See also *Global Container Lines Ltd v State Black Sea Shipping Co* [1999] 1 Lloyd's Rep 127 at 155.

[22] See *Sinclair Scott & Co Ltd v Naughton* (1929) 43 CLR 310 at 317 (Knox CJ, Rich and Dixon JJ). Their Honours said that there might be cases where "the parties were content to be bound immediately and exclusively by the terms they had agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms".

[23] See, eg, *Baulkham Hills Private Hospital Pty Ltd v G R Securities Pty Ltd* (1986) 40 NSWLR 622 at 628; *Tern Minerals NL v Kalbara Mining NL* (1990) 3 WAR 486 at 494; *Heysham Properties Pty Ltd v Action Motor Group Pty Ltd* (1996) 14 BCL 145 at 146 and 160; *Brunninghausen v Glavanics* (1999) 46 NSWLR 538 at 545; *Graham Evans Pty Ltd v Stencraft Pty Ltd* [1999] FCA 1670 (para 44), (1999) 16 BCL 335 at 347; *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101 at 110; *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886 (para 24), (2002) 18 BCL 57 at 61-62; *John R Keith Pty Ltd v Multiplex Constructions (NSW) Pty Ltd* [2002] NSWSC 43 ("the fourth class has now passed into common parlance insofar as the courts are concerned and is referred to regularly as an accepted classification" per Einstein J, para 223); *Rural Insurance (Aust) Pty Ltd v Reinsurance Australia Corporation Ltd* (2002) 41 ACSR 30 at 36.

[24] (2000) 22 WAR 101 at 110.

only remaining question should be whether, taking into account the flexible tools of construction and implication that a court has at its disposal in order to cure perceived uncertainty or incompleteness, the agreement is sufficiently complete to be workable.

Incompleteness – Agreements to Agree

For more than 70 years the decision of the House of Lords in *May & Butcher Ltd v The King*[25] has stood as authority for the proposition that there is prima facie no contract where the parties expressly state that "essential", or perhaps even "material", terms are to be agreed in the future. Subject to various exceptions, "agreements to agree" are void for incompleteness. Despite the fact that the case has at various times been ignored, reinterpreted, distinguished or otherwise outflanked, it has been remarkably resilient and influential. However, as suggested earlier and for reasons I have discussed elsewhere,[26] it should no longer be regarded as a persuasive authority on the principles of the modern law of contract.

The implications of the recent cases noted in the previous section of this paper for the survival of the *May & Butcher* principle should be fairly obvious. The courts in those cases are sanctioning enforcement of what are in substance "agreements to agree" – contracts containing a term providing for future agreement on additional terms.

It might be argued that the situation in the *May & Butcher* line of cases is different because in those cases the alleged contracts typically point to specific matters that are "to be agreed" between the parties. But, when the parties have reached consensus on what they regard as the essential terms, should it really matter that, instead of simply saying, in effect, "there will be a formal contract containing by consent additional terms", they go ahead and list the particular matters that they have recognised as requiring agreement? It is conceded that sometimes such particularisation of the matters to be agreed may be a factor supporting an inference that the parties had no intention to be bound, but we are dealing here with situations where such intention is otherwise established.

My point can be usefully illustrated by reference to the decision of the New South Wales Court of Appeal in *G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd*.[27] In this case the parties were held to have formed a binding contract for the sale and purchase of a private hospital at a price of $4.3m in the course of an exchange of

[25] (1929) [1934] 2 KB 17n.

[26] D W McLauchlan, "Rethinking Agreements to Agree" (1998) 18 NZULR 77 and "Some Further Thoughts on Agreements to Agree" (2001) 7 NZBLQ 156.

[27] (1986) 40 NSWLR 631.

correspondence recording that they had reached "a legally binding agreement in principle" until such time as formal contracts were exchanged. The court described the words "in principle" as "curious",[28] no doubt because they would normally be taken as a powerful indication that no binding contract was intended until details were agreed and formalities completed.[29] Nevertheless it was held that:[30]

> "they cannot prevail against the conclusion to be drawn from the words 'a legally binding agreement'. Those words convincingly indicate that the parties intended to be bound immediately. Probably the phrase 'legally binding agreement in principle' was intended to mean that the parties had reached agreement on the main matters and were content to be immediately bound."

The significant feature of this case is that the court enforced what was tantamount to an agreement to agree. The words "in principle" necessarily implied that agreement had yet to reached on a range of details affecting the implementation of the transaction. Indeed, the court acknowledged the point made by counsel for the defendant vendor that "the sale of a hospital containing sixty-two beds necessarily involved many complex matters which required the contractual imposition of rights and obligations extending far beyond the rudimentary conditions in the correspondence"[31] and agreed that these matters "would ordinarily require a conclusion that there was no binding agreement until formal contracts were exchanged".[32] Nevertheless it was held that "the express words of the correspondence leave no room for the inference which would otherwise be drawn from the complexity, magnitude and subject matter of the transaction".[33] Interestingly, the trial judge,

[28] Ibid at 635.

[29] The legal effect of an "agreement in principle" was considered by the New Zealand Court of Appeal in *Oracle New Zealand Ltd v Price Waterhouse Administration Ltd* 27/7/95, CA135/94. The court held that the phrase "in principle" is "commonly used to distinguish a non binding understanding from a binding commitment. It is an indication that there is no serious objection or obstacle, and that the party is willing to enter into a contract once details are settled. In commercial negotiations there is often little point in spending time and energy on settling details unless there is agreement in principle. Once that point has been reached, then it is worthwhile negotiating the details, but there is no contract until all issues have been settled. To regard an agreement in principle as binding would be to deprive the qualifying words 'in principle' of any meaning at all." Compare, however, *Ampol Ltd v Caltex Oil (Australia) Pty Ltd* (1986) 60 ALJR 225 where a letter agreement between oil companies for the exchange of petroleum products between them, which the parties described as a "statement of broad principles", was held by the High Court of Australia to be a binding contract. Despite being "couched in vague and general terms", the letter imposed an obligation on each company to supply products according to the framework agreed. It "was plainly intended to be more than a charter of the parties' rights and obligations in the event that they otherwise agreed to supply" (at 227 per Mason, Brennan and Dawson JJ).

[30] (1986) 40 NSWLR 631 at 635.

[31] Ibid at 636.

[32] Ibid.

[33] Ibid.

McLelland J,[34] had earlier rejected the specific argument that, since so many other terms remained to be agreed, there was "an 'agreement to agree' on those other terms" and hence "the consensus was incapable of forming a binding contract".[35] His Honour had said:[36]

> "I do not accept that the words 'agreement in principle' in the present context import the idea that there must necessarily be agreement on further terms to be embodied in the 'formal contract' provided for in the consensus, as opposed to an expectation that there would or might be agreement on further terms to be so embodied. In other words, I do not consider that the phrase in question should be construed as an 'agreement to agree' on further terms, but rather as an indication, at the most, of an expectation of agreement on further terms."

In fact I would argue that even the designation of terms as "to be agreed" is not necessarily an indication that there are no binding commitments until these terms are settled. It is more often an indication of the parties' understanding that the matter is capable of being agreed in the future and that it is their expectation that it will be agreed. Surely it could not have made any difference to the outcome in the *G R Securities* case if the parties had specifically noted some of the important details that remained to be settled. It might even be possible to argue that in such a situation the case for finding a binding contract is actually strengthened. The identification of the particular topics requiring further negotiation or agreement might be seen as "implying that the other provisions in the agreement are intended to be binding".[37]

Must Unagreed Terms be "Inessential"?

It might also be argued that I am reading too much into the modern preliminary agreement cases because they are concerned only with situations where "inessential" terms have not been agreed. They have no relevance where an essential term, for example the price (as in *May & Butcher*), is stipulated as "to be agreed". The answer to this objection is to be found in the instructive judgment of Lloyd LJ (with whom the other members of the English Court of Appeal agreed) in *Pagnan SpA v Feed Products Ltd*.[38] His Lordship said:[39]

[34] *Baulkham Hills Private Hospital Pty Ltd v G R Securities Pty Ltd* (1986) 40 NSWLR 622.
[35] Ibid at 628.
[36] Ibid.
[37] *Ampol Ltd v Caltex Oil (Australia) Pty Ltd* (1986) 60 ALJR 225 at 233.
[38] [1987] 2 Lloyd's Rep 601 at 619. See also *Neilson v Stewart* [1991] SC 22 at 39 (HL) ("The fact that in the usual case a particular term will be considered essential to the existence of a concluded agreement does not prevent parties from contracting in a particular case that it shall not be essential").
[39] Emphasis added.

"It is sometimes said that the parties must agree on the essential terms and that it is only matters of detail which can be left over. This may be misleading, since the word 'essential' in that context is ambiguous. If by 'essential' one means a term without which the contract cannot be enforced then the statement is true: the law cannot enforce an incomplete contract. If by 'essential' one means a term which the parties have agreed to be essential for the formation of a binding contract, then the statement is tautologous. If by 'essential' one means only a term which the Court regards as important as opposed to a term which the Court regards as less important or a matter of detail, the statement is untrue. It is for the parties to decide whether they wish to be bound and, if so, by what terms, whether important or unimportant. It is the parties who are, in the memorable phrase coined by the [trial] Judge [Bingham J], 'the masters of their contractual fate'. Of course the more important the term is the less likely it is that the parties will have left it for future decision. *But there is no legal obstacle which stands in the way of the parties agreeing to be bound now while deferring important matters to be agreed later. It happens every day when parties enter into so-called 'heads of agreement'.*"

Thus, what would normally be an essential term, such as price in a sale of goods agreement, may sometimes be inessential. Suppose that a farmer signs an agreement to sell all of her next crop that is due to be harvested in three months time. The agreement states "price per tonne to be agreed before delivery". This is because market rates cannot be determined until after harvesting when supply and demand conditions will be known. There is prima facie no binding contract in this situation according to the *May & Butcher* principle,[40] but the opposite conclusion should be reached because price is an inessential term in the circumstances. It is likely that the parties' priority is to secure firm advance commitments to sell and buy the specified quantity. Immediate agreement on price is not an issue because their intention is that the price to be agreed later is the fair market value of the goods.

However, it is perhaps fair to suggest that, on Lloyd LJ's approach, one does not need to address as a separate question whether the term deferred for future agreement was "essential". When the passage quoted above is read in the light of his Lordship's immediately preceding observations that "the parties may intend to be bound forthwith even though there are further terms still to be agreed or some further formality to be fulfilled"[41] and that failure to reach

[40] See the New Zealand Court of Appeal's judgment in *Smith v Alex McDonald (Merchants) Ltd* 20/11/87 (unreported, CA195/84 (Somers, Casey and Chilwell JJ)), criticised in D W McLauchlan, "Rethinking Agreements to Agree" (1998) 18 NZULR 77 at 94-95.

[41] [1987] 2 Lloyd's Rep 601 at 619.

agreement on the deferred terms will only defeat the parties' intention to be bound if it "renders the contract as a whole unworkable or void for uncertainty",[42] it would appear that there are really only *two* questions to be addressed when the enforceability of a preliminary agreement is in issue. First, did the parties intend to be bound immediately by the agreement they had reached? Secondly, if they did, is that agreement sufficiently certain and complete? Thus, if it is found that the parties did intend to be bound and that their agreement, perhaps with the aid of implied terms,[43] is workable, the terms not needed to make the agreement work, including any term deferred for future agreement, must, ex hypothesi, be *inessential*.

RECENT AUSTRALIAN ILLUSTRATIONS

Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd[44]

The difference between the modern approach to preliminary agreements and the traditional formalistic approach of the common law can be usefully illustrated through a comparison of the majority and minority conclusions on the facts in *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd*, an interesting Australian analogue to the decision of the New Zealand Court of Appeal in *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[45] which will be discussed shortly. The case concerned a HoA entered into between two mining companies. The respondent, whose main interest was gold exploration, was the owner of various mining tenements in Western Australia. The appellant was a nickel miner who wished to explore the respondent's tenements for base metals with a view to mining. After some 20 months of negotiations the parties signed a HoA containing five terms. First, the appellant would make three payments to the respondent totalling $250,000. Secondly, the appellant would spend $500,000 on the respondent's tenements over three years "to earn a 100 percent interest in any base metals discovered". Thirdly, the respondent would retain a 1 percent gross royalty on revenue from any base metals, capped at $10 million. Fourthly, the respondent would retain a 100 percent interest in any

[42] Ibid.

[43] The modern approach is that "in a case where it is apparent that the parties have not attempted to spell out the full terms of their contract, a court should imply a term by reference to the imputed intention of the parties if … it can be seen that the implication of the particular term is necessary for the reasonable or effective operation of a contract of that nature in the circumstances of the case": per Deane J in *Hawkins v Clayton* (1988) 164 CLR 539, 573, a view since endorsed in *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 and *Breen v Williams* (1996) 186 CLR 71.

[44] (2000) 22 WAR 101.

[45] [2002] 2 NZLR 433.

precious metals discovered. Fifthly, 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 document then concluded: "The above 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." The appellant made the first payment required by the agreement and over the following 15 months spent $120,000 carrying out preliminary exploration work. Negotiations for the proposed fuller agreement also proceeded but they eventually broke down after a change in the respondent's management and, it seems, a consequential realisation that the tenements were far more valuable than they were when the HoA were entered into. The respondent resisted the appellant's claim that it had a legally binding contract arguing, inter alia, that the agreement was not intended to be binding and that, in any event, it was void for uncertainty or incompleteness. The trial judge found for the respondent but his decision was reversed by a 2:1 majority in the Supreme Court of Western Australia.

The major difficulty faced by the appellant was that the agreement was, at least on its face, silent on a number of important matters affecting its implementation and day-to-day operation. For example, it did not deal with: the parties' respective rights to title in the tenements; their rights in situations where concurrent exploration or mining might occur; responsibility for statutory expenditure requirements in respect of the tenements; responsibility for dealing with native title claimants; or dispute resolution procedures. There were also a number of respects in which it was alleged that the terms in the HoA were too uncertain. The approaches of the majority and minority judges to the resolution of these matters stand in stark contrast.

The majority judges (Ipp J, with whom Pidgeon J agreed) were satisfied that the parties did intend to be bound by the HoA. There were powerful indications to that effect on the face of the document that were not displaced by anything in their prior negotiations or subsequent conduct. Indeed, the partial implementation of the agreement supported the appellant's contention. Further, the alleged respects in which the agreement was incomplete or uncertain were rejected. The matters in question either did not require resolution, or they were already covered by the express terms, or they were capable of resolution if a dispute arose through the usual processes of construction and implication (implied considerations of reasonableness). There were no doubt ambiguities but these did not make the agreement uncertain or incomplete. They simply provided good commercial reasons for the parties to get on and conclude their more detailed agreement. Failure to do so would make the mining operations more difficult and expensive,

but the HoA was not *unworkable* "in the sense of it being objectively impossible for performance of its terms to be effected".[46]

The minority judge, Anderson J, held that the HoA was a "limited consensus" concerning "the broad parameters of an agreement".[47] It was "entirely unlikely"[48] that these mining companies, "who were not tyros in the business of mineral exploration",[49] intended to be bound when so many matters critical to the implementation of the arrangement required further agreement. Further, even if the parties did intend to be bound and even if the clause providing for the fuller agreement was not "destructive of the contract",[50] the agreement was void for incompleteness. Several essential terms, most notably the title arrangements under which the parties were to exercise their respective rights, had not been agreed.

The above summary does not do justice to the lengthy and complex judgments delivered. It is not intended to do so. Rather, it is necessary background to my main point, which is that what essentially divided the judges was not simply different factual inferences concerning the importance of matters such as title arrangements, nor even different perceptions of what the commercial world regards as binding commitments. One also finds on close analysis different interpretations of (or emphases on) the relevant legal principles. Thus, as noted earlier,[51] Ipp J accepted the proposition that a finding of intention to be bound immediately by an informal agreement is not precluded by the fact that the parties contemplate execution of a more formal agreement containing additional terms yet to be agreed. The fact that significant matters remain to be agreed "can bear upon the determination of whether the parties intended to contract"[52] but it is not conclusive. By contrast, Anderson J adhered to the three categories in *Masters v Cameron*[53] and hence saw the parties' acknowledgment of the need for agreement on additional terms as precluding formation of a binding contract. Interestingly, his Honour thought that there were two separate reasons for avoiding the alleged contract on the ground of incompleteness. The provision for a fuller agreement meant that there was a mere "agreement to agree" and, in any event, the parties had failed to agree on essential terms. Secondly, while both judges accepted that omission of an essential term will invalidate the contract, Ipp J adopted the principle laid down by Lloyd LJ in *Pagnan SpA v Feed Products Ltd*[54]

[46] (2000) 22 WAR 101 at 127.
[47] Ibid at 141.
[48] Ibid at 136 and 140.
[49] Ibid at 138.
[50] Ibid at 143.
[51] See text at n 24.
[52] (2000) 22 WAR 101 at 111.
[53] (1954) 91 CLR 353 at 360-361. See above, text at n 13.
[54] [1987] 2 Lloyd's Rep 601 at 619.

that essentiality is a matter for the parties to determine, not the court.[55] Anderson J, on the other hand, seemed to proceed on the basis that any important matter requiring agreement for the effective implementation of the transaction was essential. Thirdly, Ipp J stressed the principles that ambiguity in essential terms does not mean uncertainty, that a finding of uncertainty requires that the language be "so obscure and so incapable of any definite or precise meaning that the court is unable to attribute to the parties any particular contractual intention",[56] and that the courts should be astute to adopt constructions which uphold bargains, not destroy them. These principles barely rate a mention in the judgment of Anderson J, who was far less predisposed to uphold the HoA. He did acknowledge "the principle that courts should be the upholders and not the destroyers of bargains", but said that it "is not applicable where the issue to be decided is whether the parties intended to form a concluded bargain" or, in other words, "whether there is anything to uphold".[57]

LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd[58]

This case concerned a claim for breach of contract based on a HoA containing the terms on which the plaintiffs would be appointed manager of Melbourne's Colonial Stadium if any of the defendant's bids for the construction of that stadium were successful. In the New South Wales Supreme Court Barrett J held that that HoA did have contractual force, but he dismissed the plaintiff's claim on the ground that a condition precedent was not satisfied. Only the former ruling need concern us here.

The crucial feature of the HoA that enabled the judge to conclude that it took effect as a contract was the inclusion of the following recital:

> "If any of the Bids are successful the parties intend to enter into a formal Facility Management Agreement, but, in the meantime, intend this Heads of Agreement to be legally binding."

It was held that this express statement of contractual intention prevailed over the contrary inferences that might otherwise have been drawn from the various areas of incompleteness and possible uncertainty in the HoA. There were numerous respects in which the agreement was sloppily drafted (for example, inappropriate or incomplete clauses, undefined terms, and cross-references to non-existent or irrelevant provisions), but the judge found that these problems were capable of being resolved as a matter of interpretation or by making reasonable implications. Of greater

55 (2000) 22 WAR 101 at 112 and 128.

56 *G Scammel & Nephew Ltd v Ouston* [1941] AC 251 at 268 per Lord Wright.

57 (2000) 22 WAR 101 at 133.

58 [2001] NSWSC 886; (2002) 18 BCL 57.

concern was the fact that several clauses deferred matters for subsequent agreement between the parties and that no machinery was provided to fill the gaps if the parties did not agree. The judge dealt with this aspect of the case by accepting that there is now a fourth category of case additional to the three mentioned in *Masters v Cameron*[59] and by adopting the "guiding principle"[60] stated by Lloyd LJ in *Pagnan SpA v Feed Products Ltd* that "there is no legal obstacle which stands in the way of the parties agreeing to be bound now while deferring important matters to be agreed later".[61] He saw the central question as being whether the terms of the HoA not affected by the "agreement to agree" elements were "sufficiently cohesive and coherent to stand as a contract in their own right",[62] which appears to be essentially the same as Lloyd LJ's test of workability, and had little apparent difficulty in giving an affirmative answer to that question. Some of the items deferred for future agreement related to operational matters so that it was "not meaningful to think of a single and definitive prescription at the commencement of a 20 year term".[63] The parties were "really flagging, in these areas, matters upon which they will need to consult and agree periodically in the light of changing circumstances as the term progresses".[64] Nor were the other items, those not of a "periodic nature",[65] so pervasive that the remaining terms of the HoA were insufficiently cohesive and coherent to stand as a contract. The functions and responsibilities of the manager, the initial term and the fee payable were defined. There were also "meaningful and complete provisions on record keeping and reporting".[66] In fact "the basic transaction … was not of great complexity and was, in many ways, conceptually akin to a contract of employment or contract for services where the central terms are often so straightforward as to require little by way of writing".[67] The Judge then concluded by observing, that "[i]n terms of the *Masters v Cameron* classes, the heads of agreement fall into either the first or the fourth".[68] This is rather surprising since the first of *Masters v Cameron* classes only applies where "the parties have reached finality in arranging all the terms of their bargain".[69]

[59] (1954) 91 CLR 353 at 360-361. See above, text at n 13.
[60] (2002) 18 BCL 57 at 63 (para 33).
[61] [1987] 2 Lloyd's Rep 601 at 619. See above, text at n 39.
[62] (2002) 18 BCL 57 at 64 (para 35).
[63] Ibid (para 36).
[64] Ibid.
[65] Ibid (para 37).
[66] Ibid.
[67] Ibid.
[68] Ibid (para 38).
[69] *Masters v Cameron* (1954) 91 CLR 353 at 360.

THE NEW ZEALAND POSITION – FCE v ECNZ

Introduction

In the important recent case of *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd*[70] (hereafter *FCE v ECNZ*), the New Zealand Court of Appeal was called upon to decide whether a HoA for the long-term supply of gas by the respondent (FCE) to the appellant (ECNZ) was a binding contract. The gas to be supplied was estimated to be worth between $1.2 and $1.8 billion and, if FCE were successful in their contention that a binding contract had been formed, ECNZ faced a potential multi-million dollar damages bill. As it transpired, the court by a majority (Thomas J dissenting) rejected FCE's contention and overturned Wild J's decision in their favour.[71] Most observers would have anticipated that, if this were to occur, it would have been on the basis that the HoA was not sufficiently complete or certain to constitute a binding contract. Instead the court, in a judgment delivered by Blanchard J, accepted ECNZ's first main argument that the agreement was not intended to be legally binding. It was in the nature of a progress report to the board of ECNZ. The parties "had simply reached an important staging post on the way to final agreement".[72] The court also gave an alternative ground for its decision that is almost equally surprising. It was held that a condition precedent requiring approval of the HoA by the board of ECNZ had not in fact been satisfied, despite unequivocal advice to the contrary from senior management of the corporation.

The Facts

Late in 1995 FCE and ECNZ began negotiations concerning the long-term supply of gas by FCE to ECNZ. The government's reform of the electricity industry had left ECNZ short of gas to fuel its dual gas/coal fired station at Huntly. FCE was New Zealand's largest oil and gas producer. It had a 68.75 percent interest in the Maui oil and gas field (which was expected to be depleted by 2009) and a 22.5 percent interest in the Kupe field (expected to be depleted by 2011). Negotiations continued throughout 1996 but they eventually broke down in early January 1997. Although a detailed term sheet prepared by ECNZ showed that a significant measure of agreement had been reached, it seems that, due to its other commitments, FCE was unable to satisfy ECNZ's need for a secure long-term supply.

[70] [2002] 2 NZLR 433.
[71] *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2001] 2 NZLR 219.
[72] [2002] 2 NZLR 433 at 450 (para 74).

In the meantime, in 1996 FCE had set its sights on acquiring a larger stake in Kupe. It purchased a 20 percent interest held by other joint venture parties and then submitted a bid for the 40 percent interest of Western Mining Corporation (WMC) when the latter decided to sell by open tender. ECNZ also submitted a closely competing bid whereupon WMC decided to conduct a second bidding round with a 28 February 1997 deadline. When FCE learned that ECNZ was the only competing bidder it approached ECNZ "with a view to a mutually beneficial proposal".[73] This proposal was accepted by ECNZ. An agreement was negotiated over the phone on 26 and 27 February between the two chief executives, Messrs Fletcher of FCE and Frow of ECNZ, and a letter agreement recording the terms was signed by them both the following day. This came to be known as the "Fletcher/ Frow letter". There were four aspects to the agreement. First, ECNZ and FCE would that day re-submit their previous bids for WMC's interest in Kupe and, if either was accepted, they would split the interest 25.75 percent to ECNZ and 14.25 percent to FCE. Secondly, and most importantly:

> "By the end of today, ECNZ and Fletcher Challenge Energy 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 ECNZ Board approval within eight days."

Thirdly, certain terms relating to the development and operation of the Kupe field were agreed. Finally, the parties agreed that "in the event of ambiguity or uncertainty Messrs Frow and Fletcher will interpret the current intent and that will prevail".

In the meantime, on 27 and 28 February, senior officials of the companies met to negotiate the HoA. Lawyers were deliberately excluded and, with the benefit of the term sheet from the earlier negotiations, relatively quick progress was made. However, the major obstacle remained that ECNZ wanted to secure a firm gas supply through to 2017 whereas FCE was unwilling to commit itself beyond 2011. Eventually a compromise was reached whereby FCE was obliged to deliver beyond 2011 but "only if delivery is economic". The HoA was duly signed during the afternoon of 28 February, as it had to be if the parties were to re-submit their previous bids for the WMC Kupe interest pursuant to the Fletcher/Frow letter by close of business on that day. If the HoA had not been signed, FCE and ECNZ would each have resubmitted their earlier bids or made higher bids, so that

[73] *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand Ltd* [2001] 2 NZLR 219 at 226 (para 20) per Wild J.

one of them would have acquired the WMC interest to the exclusion of the other.

The HoA, which is usefully set out in a schedule to the Court of Appeal judgments, was nearly four pages in length. It was headed:

FCE/ECNZ Gas Contract
Heads of Agreement

Each clause consisted of a heading in the margin with the substance of what was agreed set out opposite. For example:

"Quantities	Contract year commences/ends 1 October/ 30 September each year.
	2000 - 2002: 10PJ/yr = AQ
	2002 - 2017: 20PJ/yr = AQ
Maximum Delivery Obligation:	120% of average daily quantity ie. 365/AQ"

Two matters were stated to be conditions precedent. The first was the securing of the 40 percent Kupe stake. The second was ECNZ board approval. The final clause, opposite the heading "Time Frame for Proceeding" stated:

"FCE/ECNZ to use all reasonable endeavours to agree a full sale and purchase agreement within three months of the date of this agreement."

According to the Court of Appeal, the HoA had "four unusual features":[74]

> "The words 'to be agreed' appear against the efficiency factor (K) in the formula for calculating the liability of FCE for non-delivery of gas (other than due to force majeure). The words 'Not agreed' appear under the marginal heading 'Force Majeure' and in the text of that item there is the statement '(Not agreed: Extension to National Grid)'. Below the marginal heading 'Prepaid Gas Relief' there is the notation 'not agreed'. Finally, above the signatures, there is the following:
>
> 'Agreed (except where indicated)'."

Another clause that featured in the court's reasoning should also be noted. Alongside the marginal heading "Other Liabilities" it was provided that there was to be an "[a]dditional clause covering non supply liabilities".

[74] [2002] 2 NZLR 433 at 436-437 (para 14).

Immediately after the HoA was signed the parties re-submitted their previous bids for WMC's Kupe interest. They were advised on 4 March 1997 that FCE's bid had been successful. On 12 March Messrs Fletcher and Frow re-signed an amended version of their letter, the main change being that the time for ECNZ board approval of the HoA was extended from eight days to 13 days. The board met on the same day and passed a resolution stating, inter alia, that "the Heads of Agreement for the contract for the sale of gas between FCE and ECNZ be approved, subject to challenging the provision that FCE should only deliver gas in the period 2011–2017 if such delivery were to be economic". A committee of the board was also appointed "to approve the final contract". The following day FCE was advised by telephone that ECNZ's board had given approval to the HoA. Nothing was said about the qualification concerning gas deliveries from 2011 to 2017.

Over the following three weeks the parties focused on implementing the purchase of WMC's interest in Kupe. Final settlement in accordance with the terms of the Fletcher/Frow letter was duly completed on 27 March. Negotiations for the full supply agreement began on 3 April 1997 and continued until they finally collapsed in January 1998. Ostensibly, the major reason for the impasse was disagreement on the question of the "economic test", which determined whether FCE could decline to deliver gas after 30 September 2011. However, as the Court of Appeal pointed out:[75]

> "In the meantime, developments in the electricity market had altered ECNZ's view about the prices set under the HoA. Lower price forecasts predicting future oversupply of electricity coupled with the development of the government's plans for further re-structuring of ECNZ and the electricity market made the gas supply from FCE a less attractive proposition."

Eventually ECNZ took the stance that the HoA did not constitute a legally binding contract and declined to proceed with the purchase of gas. FCE instituted proceedings seeking declarations that the HoA was a legally binding contract and that ECNZ had breached a binding obligation to use all reasonable endeavours to agree on the full sale and purchase agreement.

In the High Court Wild J accepted all of FCE's main arguments. The HoA was intended to be binding, it was sufficiently complete and certain to be enforceable, the condition precedent relating to ECNZ board approval was satisfied and ECNZ breached a binding obligation to use all reasonable endeavours to agree a full sale and purchase agreement. Only the second of these findings was upheld in the Court of Appeal.

[75] Ibid at 438 (para 24).

The Correct Legal Approach

The Court of Appeal began the substantive part of its reasoning by discussing at length the principles of contract formation affecting enforceability of the HoA. Unlike the decision on the facts, most of the points are unlikely to occasion much dispute. Further, in a number of respects, the reasoning provides some welcome clarification of the law of contract formation and confirmation of the general approach to issues of intention and incompleteness outlined earlier in this paper.

Intention to be bound

The court introduced its analysis by observing:[76]

> "The question whether negotiating parties intended the product of their negotiation to be immediately binding upon them, either conditionally or unconditionally, cannot sensibly be divorced from a consideration of the terms expressed or implicit in that product. They may have embarked upon their negotiation with every intention on both sides that a contract will result, yet have failed to attain that objective because of an inability to agree on particular terms and on the bargain as a whole. In other cases, which are much less common, the intention may remain but somehow the parties fail to reach agreement on a term or terms without which there is insufficient structure to create a binding contract. This latter situation is uncommon because normally negotiating parties will have an appreciation of what basic terms they need to reach agreement upon in order to form a contract of the particular type which they are negotiating. It is comparatively rare that, having an intention to contract immediately, not only do they fail to deal expressly with an essential or fundamental term but it also proves impossible for the Court to determine the contractual intent in that regard by implication of a term or by reference to what was reasonable in the particular circumstances or to some other objective standard.
>
> A contract is not legally incomplete merely because consequential matters have been omitted, particularly when they relate to questions of contingency and risk allocation. The parties may have thought it unnecessary to the essence of their bargain to reach agreement upon such matters or it may have been difficult or even impossible to predict what might arise in the future, particularly under a long term contract. It may therefore have been thought satisfactory – and it would often be more

[76] Ibid at 443 (paras 50–51).

> economically efficient – to leave such matters to be worked out if necessary in the course of the performance of the contract."

Then, in a passage that signalled the basis on which the case would be decided, the court continued:[77]

> "But even where the parties are ad idem concerning all terms essential to the formation of a contract – the basic structure of a contract of the type under negotiation is found to have been present in the terms which have been agreed – they still may not have achieved formation of a contract *if there are other unagreed matters which the parties themselves regard as a prerequisite to any agreement* and in respect of which they have reserved to themselves alone the power of agreement. *In such cases, what is missing at the end of the negotiation is the intention to contract, not a legally essential element of a bargain*. (In theory, it is of course possible that, having concurred that a legally inessential matter is in fact essential to them in the particular circumstances, the parties have then overlooked it in the turmoil of negotiation and mistakenly have thought that they have agreed everything essential, when in fact they have not. But this would be very unusual and certainly did not happen in the present case.)
>
> The prerequisites to formation of a contract are therefore:
>
> (a) An intention to be immediately bound (at the point when the bargain is said to have been agreed); and
>
> (b) An agreement, express or found by implication, or the means of achieving an agreement (eg an arbitration clause), on every term which
>
> (i) was legally essential to the formation of such a bargain; or
>
> (ii) was regarded by the parties themselves as essential to their particular bargain.
>
> A term is to be regarded by the parties as essential if one party maintains the position that there must be agreement upon it and manifests accordingly to the other party."

The latter paragraph is not without difficulty because proposition (b)(ii) in fact goes to the question in (a) of intention to be bound. As the court itself indicated in the previous paragraph, failure by the parties to agree on a matter that they "themselves regard as a prerequisite to any agreement" means that "what is missing at the end of the negotiation is the intention to contract, not a legally essential element of a bargain". Subject to this qualification, the court's statement of principle is unexceptionable. It is important to stress this point here in order to make it clear that my later criticism of the

[77] Ibid at 443-444 (paras 52–53), emphasis added.

decision in this case relates to the application of the principle to the facts, not the principle itself. For it is beyond question that if in the course of negotiations a party takes, and does not later resile from, the position that there must be agreement on a particular term before he or she will commit to the bargain and, in the words of the court, "manifests accordingly to the other party", there can be no binding contract if agreement on that term is not reached. It does not matter that the term is, in the context of the transaction as a whole, a minor one or that the party is otherwise acting unreasonably. A party is perfectly entitled to say, in effect: "I am not prepared to commit myself until we have agreed on this [minor matter]". Provided that this actual intention not to be bound is adequately communicated to the other party, in the sense that that party at least either knows or ought to know of it, it will completely override factors indicating that it was reasonable to infer intention to be bound. This is important because, in the usual case where evidence of such actual intention is lacking, the task of the court will be to balance all the factors in order to determine whether the plaintiff was reasonably entitled to infer that the defendant intended to be bound.

With regard to proposition (b)(i), it appears that a "legally essential" term, as opposed to a term that the parties themselves regard as essential to their bargain, is, in the words of the court quoted at the beginning of this section, one "without which there is insufficient structure to create a binding contract". It is not simply, as is so often assumed, an "important", "vital" or "fundamental" term because, for example, it is well accepted, and acknowledged by the court later in its reasoning, that there may be a binding contract of sale even though the parties have not agreed on the price. So long as there is "a skeleton of express terms combined with an intention to contract"[78] the gaps can be filled by reasonable implications unless the failure to reach agreement is such as to render the contract "unworkable", that is, "the transaction is lacking in business efficacy",[79] or, in the similar words of Thomas J, it is "incapable of enforcement".[80]

Admissibility of extrinsic evidence

The court has confirmed that, in determining the question of intention to be immediately bound when parties have entered into a HoA (or other informal agreement that is intended to be replaced later by a fuller agreement), the "established" restrictions on the admissibility of extrinsic evidence in interpretation disputes do not apply. Evidence of "statements the parties made orally or in writing in the course of their

[78] Ibid at 448 (para 64).
[79] Ibid at 448 (para 65).
[80] Ibid at 462 (para 128).

negotiations and drafts of the intended contractual document"[81] may be received. In so ruling the court adopted the view of McHugh JA in *Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd*[82] that the parol evidence rule does not apply until it has been determined that a contract was formed because "the intention to be bound is a jural act separate and distinct from the *terms* of their bargain".[83]

However, the court was not prepared to endorse a relaxation of all restrictions on the admissibility of extrinsic evidence. Thus, after noting that it was "also permissible … to look at subsequent conduct of the parties towards one another, including what they have said to each other after the date of the alleged contract",[84] the court continued:[85]

> "[A]s Gleeson CJ observed in [*Australian Broadcasting Corporation v XIVTH Commonwealth Games Ltd* (1988) 18 NSWLR 540, 550], the position is by no means so clear in connection with internal memoranda, communications of one party with a third party or statements of subjective intention made by individuals in the course of giving evidence. We have proceeded on the basis of treating such material as admissible but we share that reservation, particularly in relation to direct expressions of subjective intent."

The present is not an appropriate occasion for an extended discussion of this issue, but it is difficult to see any principled basis for excluding such evidence. The issue is one of *weight*, not admissibility. For example, internal memoranda or communications with a third party that emanate from persons in authority will sometimes provide very reliable indications that a party intended to be bound. Similarly, if a promisor says in evidence "Yes, I intended to be bound", that surely is an admission which, unless explained away satisfactorily, should be sufficient to resolve the case if the court is convinced that the promisee had the same intention.

Intention, incompleteness and uncertainty

A number of well established principles were reaffirmed by the court in the course of its description of the correct legal approach to issues of intention to be bound, incompleteness and uncertainty. First, the court must be "entirely neutral" in determining whether the parties intended to be bound but, when that question is given an affirmative answer, its task is to do its best to give effect to the bargain

81 Ibid at 444 (para 54).
82 (1985) 2 NSWLR 309 at 337.
83 [2002] 2 NZLR 433 at 444 (para 55).
84 Ibid at 444 (para 56).
85 Ibid at 444-445 (para 56).

despite apparent incompleteness or uncertainty.[86] Secondly, issues of intention and incompleteness are closely related in the sense that, as Gleeson CJ said in the *Australian Broadcasting Corporation* case,[87] "other things being equal, the more numerous and significant the areas in respect of which the parties have failed to reach agreement, the slower a court will be to conclude that they had the requisite contractual intention." Thirdly, mere ambiguity is not a reason for holding a contract void for uncertainty:[88]

> "It is only if there is such uncertainty in an essential term that the Court cannot determine what the parties meant that the agreement will be held to be meaningless or void – where 'the language used was so obscure and so incapable of any definite or precise meaning that the court is unable to attribute to the parties any particular contractual intention' (*G Scammell & Nephew Ltd v Ouston* [1941] AC 251 per Lord Wright at p 268). Where the term in question is meaningless but inessential (both in law and to the parties) it will simply be disregarded in determining the rights of the parties under the contract."

Agreements to agree

Perhaps the most important aspect of the court's analysis of the correct legal approach is that it has finally been persuaded to reject the decision of the House of Lords in *May & Butcher Ltd v The King*[89] which, as mentioned earlier,[90] for more than 70 years has stood as authority for the general rule that a mere "agreement to agree", an agreement that defers a term or terms of an otherwise complete bargain for future agreement between the parties, is void for incompleteness. Thus, the court said:[91]

> "Something should be said about the place that the controversial decision of the House of Lords in *May and Butcher Ltd v The King* [1934] 2 KB 17n has in the modern law of contract. We take the view that this case is no longer to be regarded as authority for any wider proposition than that an 'agreement' which omits an essential term (or, as Lord Buckmaster called it, 'a critical part'), or a means of determining such a term, does not amount to a contract. No longer should it be said, on the basis of that case, that prima facie, if something essential is left to be agreed upon by the parties at a later time,

[86] Ibid at 445 (para 58), citing *Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503; *R & J Dempster Ltd v Motherwell Bridge and Engineering Co Ltd* 1964 SC 308 and *Attorney-General v Barker Bros Ltd* [1976] 2 NZLR 495.
[87] (1988) 18 NSWLR 540 at 550.
[88] [2002] 2 NZLR 433 at 448 (para 67).
[89] (1929) [1934] 2 KB 17n.
[90] Text at n 25.
[91] [2002] 2 NZLR 433 at 446-447 (paras 60-61).

> there is no binding agreement. The intention of the parties, as discerned by the Court, to be bound or not to be bound should be paramount. If the Court is satisfied that the parties intended to be bound, it will strive to find a means of giving effect to that intention by filling the gap. On the other hand, if the Court takes the view that the parties did not intend to be bound unless they themselves filled the gap (that they were not content to leave that task to the Court or a third party), then the agreement will not be binding.
>
> On its own facts we respectfully doubt that *May and Butcher* would be decided by Their Lordships in the same way today. We are now perhaps more accustomed to resort to arbitration in order to settle even matters of considerable importance to the contracting parties. We find curious the notion that, in a commercial contract where price is left to be agreed, a reasonable price cannot be fixed and that, even where there is an arbitration clause, that clause cannot be used to determine the price because 'unless the price has been fixed, the agreement is not there' (p 20)."

This passage represents welcome progress towards modernisation of the law of contract formation. It now appears that an apparent contract containing an "agreement to agree" will no longer be prima facie void for incompleteness if the court is satisfied that the parties intended to be bound. The court should strive to fill the gap through the implication of what is reasonable. This coincides with my view[92] that agreements intended to be legally binding ought never to be rejected simply on the ground that a material term was deferred for future agreement between the parties. The fact that a term is designated as "to be agreed" will often be simply an indication of the parties' understanding that the term is capable of being agreed in the future and that it is their intention to do so, not that there is to be no contract until such agreement is reached. Such an understanding is perfectly consistent with the existence of the further intention that, failing agreement, the gap is to be filled if possible by reference to the objective standard of what is reasonable in the circumstances.

Endorsement of Pagnan approach

Having rejected *May & Butcher*, the court proceeded to endorse the principles of contract formation laid down by Lloyd LJ in *Pagnan SpA v Feed Products Ltd*.[93] As discussed earlier, these principles are, plainly incompatible with the existence of a general rule that an "agreement

[92] D W McLauchlan, "Rethinking Agreements to Agree" (1998) 18 NZULR 77 and "Some Further Thoughts on Agreements to Agree" (2001) 7 NZBLQ 156.

[93] [1987] 2 Lloyd's Rep 601 at 619.

to agree" is void for incompleteness. In an important passage the court said:[94]

> "A helpful analysis of various possible situations is given by Lloyd LJ in *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601at p 619. After pointing out that the parties may intend to be bound forthwith even though there are further terms still to be agreed, His Lordship said that, if they then failed to reach agreement on the further terms, the existing contract is not invalidated unless the failure to reach agreement renders the contract as a whole 'unworkable' or void for uncertainty. By 'unworkable' we take him to mean that the transaction is lacking in business efficacy. Lloyd LJ continued:
>
> > 'It is sometimes said that the parties must agree on the essential terms and that it is only matters of detail which can be left over. This may be misleading, since the word "essential" in that context is ambiguous. If by "essential" one means a term without which the contract cannot be enforced then the statement is true: the law cannot enforce an incomplete contract. If by "essential" one means a term which the parties have agreed to be essential for the formation of a binding contract, then the statement is tautologous. If by "essential" one means only a term which the Court regards as important as opposed to a term which the Court regards as less important or a matter of detail, the statement is untrue. It is for the parties to decide whether they wish to be bound and, if so, by what terms, whether important or unimportant. It is the parties who are, in the memorable phrase coined by the [trial] Judge [Bingham J], "the masters of their contractual fate". Of course the more important the term is the less likely it is that the parties will have left it for future decision. But there is no legal obstacle which stands in the way of the parties agreeing to be bound now while deferring important matters to be agreed later. It happens every day when parties enter into so-called "heads of agreement".'
>
> It follows that merely because an important term is deferred to be settled on a future occasion, that does not mean that there is no intention to be bound. In such circumstances, provided the Court is satisfied that the parties did intend to enter immediately into a contractual relationship, it will do its best to find a means of giving effect to that intention by determining, if possible, the outstanding matter."

[94] [2002] 2 NZLR 433 at 448 (paras 65-66).

Decision of the Court of Appeal

No intention to be bound

As already indicated, the most contentious aspect of the Court of Appeal's judgment is its conclusion that ECNZ and FCE did not intend to be legally bound when they signed the HoA. The decision illustrates yet again the stark differences that can arise in judicial perceptions of what business people regard as binding commitments. Wild J at first instance and Thomas J, the dissenting judge, had no doubt that the parties intended to be bound. According to the latter, the evidence was "overwhelming".[95] Indeed, in his view, the situation was one where it was almost fraudulent to deny that intention.[96] On the other hand, the four experienced majority judges apparently had no qualms in reaching the opposite conclusion.

In my view, Thomas J's analysis is much to be preferred. It is difficult to accept that, when the senior officials of ECNZ and FCE signed the HoA and when their respective CEOs later gathered for a celebratory drink, they were not intending to enter into or confirm binding commitments but rather were simply recognising that an important staging post on the road to final agreement had been reached. I believe that most informed business people would find the majority's conclusion incredible. They would regard Thomas J's analysis as being far more in tune with the needs and expectations of commerce.

The majority began their analysis by accepting that the parties went into the HoA negotiations "with every intention of completing a binding deal" and that "they must have appreciated that a relatively sketchy, perhaps incomplete, document was likely to result from the hurried negotiations".[97] They also dealt what FCE might have expected would be a decisive blow to ECNZ's case by accepting that the list of essential terms in the Fletcher/Frow letter was no more than illustrative of "the kind of things which might emerge as essential".[98] The CEOs had left it to their negotiators "to make the final determination by signing the HoA, subject of course to the opportunity to be reserved to ECNZ's board to withhold its approval".[99] Nevertheless, it was held that no binding contract had been formed because the negotiators themselves had not reached agreement on terms that *they considered* essential to the bargain. The essential terms were those marked "not agreed" in the HoA, namely,

95 Ibid at 460 (para 120), 467 (para 147), and 490 (para 245).
96 Ibid at 467 (para 146) and at 491 (para 247),
97 Ibid at 449 (para 68).
98 Ibid at 449 (para 69).
99 Ibid.

extension of force majeure to the national grid and prepaid gas relief.[100] The court found that, by signifying that these clauses were not agreed, the parties were indicating that essential terms remained outstanding and therefore they did not intend the HoA to be an immediately binding contract. It was not a case of the agreement being *incomplete* by reason of failure to agree on *legally* essential terms. Indeed the court later suggested that the HoA was sufficiently complete so as to be *capable* of giving rise to a binding contract. There was no contract here because, by expressly designating particular terms as not agreed, the parties were demonstrating that they did not intend to be bound before agreement on those terms had been reached. "They had simply reached an important staging post on the way to final agreement."[101] None of the factors relied on by the respondent were seen as sufficiently unequivocal to outweigh this inferred actual intention.

In my view, the court attached far too much significance to the fact that the parties had included two terms and marked them not agreed. No doubt this was unusual. It would be more common for the terms to be deleted altogether from the document or, if time were pressing, to draw a line through them and initial the change. Presumably there would have been no difficulty if either step had been taken. A binding contract would have been found. But did not marking the terms as "not agreed" have exactly the same effect? Why should one attribute to the parties an intention that there should be no contract because the terms were recorded but stated to be not agreed? Surely what is significant is that the parties signed the agreement and made it quite clear what they were agreeing to by signing immediately beneath the words "Agreed (except where indicated)". They were plainly manifesting assent to the recorded terms other than those marked "not agreed".

In any event, the parties' decision not to delete the "not agreed" terms is not all that surprising given the circumstances of the negotiations and the manner in which the HoA was put together. The situation was one of great urgency. A complex deal, which months of previous negotiations had not produced, was required to be put together in less than two working days. Lawyers were deliberately excluded to enable swift progress. With the aid of the 1996 term sheet, the terms were written up on a whiteboard one by one and typed by secretarial staff. As negotiations proceeded, it would have been quite natural to mark particular terms upon which agreement could not be reached as "not agreed". No doubt these terms would have been retained in successive drafts not only as an aide memoire but also

[100] If agreed, this provision would have given ECNZ relief by way of repayment of the price paid for gas under the TOP (take or pay) term of the HoA in the event that it could not access the gas due to force majeure or non-delivery by FCE.
[101] [2002] 2 NZLR 433 at 450 (para 74).

because, in the normal flow of give and take, attitudes might change and agreement on one or more of them might become possible. And when the deal was done, with time pressures mounting, why should the negotiators have had second thoughts about signing the document in the form it had been debated under the heading "Agreed (except where indicated)"? In this regard it is interesting to note that the court was later prepared to rely on the manner in which the HoA was put together as the probable explanation for the use of contractual language in the document (the "condition precedent"), but that factor was not mentioned at all in the course of its consideration of the significance of the "not agreed" terms.

There is also a plausible theoretical explanation for the inclusion of the not agreed terms other than those advanced by the court (that the terms were essential) and by counsel for FCE (that the terms were effectively erased). Indeed, this explanation is perhaps the most obvious one. Recording a term providing for prepaid gas relief but then marking it as not agreed would actually make it clear that there is no term of the contract that such relief is available. It has an effect that failure to make any mention of the term at all would not have. It prevents (or at least makes very difficult) a later argument that the term *was* agreed so that either the HoA should be rectified or it should be held that there was a partly written and partly oral contract. It would also preclude an argument that a term providing for prepaid gas relief should be implied.

The dissenting judgment

In characteristically forthright fashion, Thomas J delivered a powerful rebuttal of the majority's conclusion that no binding contract had been formed. He described ECNZ's argument concerning intention as seeking "to take advantage of the residual judicial 'negativism' or aversion to less than comprehensive contracts"[102] and the majority's acceptance of that argument as "frustrating".[103] The main feature of the judgment is the comprehensive analysis of the factors affecting an inference of intention to be bound and the repeated, almost scornful, rejection of the majority's conclusion that the HoA was properly characterised as in the nature of a progress report to the board of ECNZ. The main factors relied upon were: the commercial context and purpose of the HoA, the terms of the agreement and the Fletcher/Frow letter, the re-signing of the latter, the ECNZ board's approval, the internal documentation of ECNZ, the implementation of the Kupe deal and numerous other potent aspects of the parties' subsequent conduct, and, interestingly, the "speaking silence" (the things that were *not* said

[102] Ibid at 461 (para 123).
[103] Ibid at 462 (para 126).

and done if the original intention to conclude a binding agreement had changed). As I read the judgment, I found it more and more difficult to understand the majority's conclusion.

His Honour also delivered a lengthy rebuttal of the majority's view that the two "not agreed" clauses were regarded by the parties as essential terms. He considered, to take one small section of the argument, that this construction "is untenable and flies in the face of all the arguments and evidence to the contrary".[104] It represented "an improbable leap of reason", particularly given that absence of agreement on the terms did not make the HoA legally incomplete and that the words "not agreed" could "just as well indicate that they were not considered important or essential".[105] The "more probable interpretation" of the parties' conduct in signing the HoA beneath the words "Agreed (except where indicated)" was that they "were making it clear that, other than as expressly noted, the terms of the HoA had been agreed as essential and binding terms".[106] His Honour felt so strongly that the only reasonable inference was that the parties did intend to be bound that towards the end of his judgment he said:[107]

> "As I reflect on the matter in concluding, I find myself wondering whether I may not have been too quick to allow that Hope JA may have stated the point too strongly in [*Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd* (1985) 2 NSWLR 309, 319] when he said: '. . . if the mutual actual intention [of the parties who have signed a document] was that there should be a concluded contract, it would be fraudulent to deny that intent'. To FCE which acted upon the bargain struck, continued to act consistently on the basis of the HoA being a binding contract, did not shy away from calling its executives to give evidence, and mounted the arguments which I have rehearsed in this judgment, it must seem as if Hope JA's words were made to fit this case."

Agreement not void for incompleteness or uncertainty

Having held that the HoA was not intended to be binding, it was not strictly necessary for the majority to address the ECNZ's arguments that the agreement was void for incompleteness and/or uncertainty. However, they elected to do so, albeit relatively briefly, given that the dispute might proceed further.

With an ease that might have gratified counsel for FCE were it not for the decision on the first issue, the majority rejected the various

[104] Ibid at 486 (para 223).
[105] Ibid at 485 (para 223).
[106] Ibid at 486 (para 224).
[107] Ibid at 491 (para 247).

allegations of incompleteness and uncertainty, and endorsed the conclusions of Wild J. For example, the HoA was not legally incomplete as a result of failure to reach agreement on clauses relating to extension of force majeure to the national grid and prepaid gas relief. The contract was capable of working without such clauses. It did not lack legally essential ingredients.

ECNZ's arguments on the "to be agreed" K factor in the formula for limiting FCE's liability for non-delivery were given equally short shrift. The words "to be agreed" had to be considered in light of the fact that the K factor was not, in the circumstances, capable of accurate and objective measurement until after an event of non-delivery. The parties had reserved the matter for agreement if and when it needed to be agreed and (presumably), if they failed to agree, a court could step in and resolve the issue.

Of the various respects in which the HoA was alleged to be void for uncertainty, the most difficult and contentious concerned the scope of FCE's "preferred customer" delivery obligation after 30 September 2011. Under this clause FCE was only obliged to deliver if delivery was "economic". It was held that this word was capable of being interpreted by a court with the aid of expert evidence. It was certainly ambiguous, and "there might be differences of judicial opinion, as there frequently are on questions of interpretation",[108] but that did not make the agreement uncertain.

Condition precedent not satisfied

The court gave an alternative ground for finding in favour of ECNZ that is almost as extraordinary as its decision on the intention issue. It was held that the condition precedent relating to ECNZ board approval had not been satisfied despite FCE having been advised unequivocally that such approval had been given. The reasons were shortly expressed as follows:[109]

> "We have concluded that the board was merely approving progress made to date in the attempts of the negotiators to reach agreement on the terms which they considered to be essential for a binding agreement. The instructions to challenge the preferred customer clause do not read like an unconditional approval. Therefore, if we had been of the view that the HoA was intended to be a binding agreement, we would have held that the board's approval was conditional upon re-negotiation of the preferred customer clause. We would not have considered ECNZ estopped by Mr Taylor's advice on 13 March

[108] Ibid at 457 (para 112).
[109] Ibid at 457-458 (para 113).

> from relying upon the board's qualification of its approval. FCE does not appear to have acted in relation to the subsequent negotiations any differently from the way in which it would have acted had it been told of the qualification. It knew that ECNZ wanted the term clarified and it responded accordingly. The only way in which it was suggested that FCE might have acted differently related to the completion of the WMC purchase. By the time of the board approval, FCE was committed to the acquisition. Its bid had been accepted. We were not referred to any evidence suggesting that FCE would have refused to allow ECNZ to participate had it known of the board's qualification. To have done so would have required FCE to make a greater commitment to Kupe than it apparently felt comfortable with."

In my view, the ECNZ board intended to and did approve the HoA. The so-called condition of the approval, despite the "subject to" language, was more in the nature of a direction to the negotiators to seek a better deal than that provided for in the preferred customer clause. If the board did not intend to approve the HoA, why then did it appoint a committee to approve the final contract? And why did ECNZ's chief negotiator advise FCE that the condition precedent was satisfied? Was he ignorant, negligent or even fraudulent? Of course not. There is nothing to suggest that he acted outside his authority. In any event, whether or not the board's approval was conditional, this was surely an obvious case for the finding of estoppel. Astonishingly, the court denied this on the basis that there was insufficient evidence of detrimental reliance by FCE. The latter would not have acted differently in the later negotiations or in relation to the WMC purchase if it had "known of the board's qualification".

We have here an interesting instance of judicial sleight of hand. The relevant question was not, what would FCE have done if it had known of the qualification. Surely their response would have been, "Well then, is the HoA approved or not?". The relevant representation founding the estoppel was that the board had approved the HoA and hence that the condition precedent was satisfied. Did FCE act in reliance on that representation? Surely it flies in the face of reality to suggest that FCE did not. There must have been a real question as to whether any negotiations would have proceeded at all if the truth (according to the Court of Appeal) had been told. And, in relation to completion of the WMC purchase, FCE at least lost the opportunity to bargain further with ECNZ on the matter. Being well aware that ECNZ could not afford to miss out on Kupe, the company could, with some justification, have taken the stance that, if the HoA was not approved, the inter-related Kupe agreement was off.

No obligation to use reasonable endeavours

In the High Court counsel for FCE sought to establish that not only was the HoA legally binding but also that ECNZ was in breach of the final clause in the agreement that required the parties "to use all reasonable endeavours to agree a full sale and purchase agreement within three months". It was conceded that the clause was not binding if the HoA itself were not.

Wild J doubted that it was necessary to decide the point in view of his ruling that the HoA was binding. However, he proceeded to do so because he was asked to, and because he was "uncertain as to the ramifications, particularly in terms of relief".[110] At first sight it seems surprising that counsel for FCE were not content simply to establish that the HoA was binding until replaced by a full agreement. One would have thought that establishing a breach of the reasonable endeavours clause would have been a fall back position in the event of a ruling that the HoA was not binding, but it may be that counsel anticipated that establishing a breach of the clause could have an impact on the quantum of damages eventually recoverable. In any event, Wild J held that the clause was sufficiently certain to be legally enforceable and that ECNZ did breach the obligation. The corporation "did not use all reasonable endeavours to reach full agreement, but rather endeavoured first to negotiate a different agreement, and subsequently to get out of any agreement".[111] In particular, it sought to secure a firm gas supply through to 2017, which it knew the HoA did not give, initially by demanding a "company wide" economic test (so that FCE would be obliged to deliver gas unless it was "going under") and, later, by seeking extension of force majeure to the national grid. Then, after market conditions had changed adversely, "ECNZ altered tack and made its first priority in the negotiations the achieving of a later start date to the contract".[112] For these main reasons Wild J reached the somewhat damning conclusion that "at no stage did ECNZ use all reasonable endeavours to convert what had been agreed in the HoA into a full gas supply agreement".[113]

In the Court of Appeal counsel for FCE altered their stance by arguing that ECNZ was legally obliged to use all reasonable endeavours even if the HoA were not binding. The court described this contention as "quite hopeless" and then proceeded to conclude that "even if the clause were part of an otherwise binding HoA, we would have difficulty in seeing that, because of the nature of the 'not agreed' items, it could create any legally enforceable obligation to

[110] [2001] 2 NZLR 219 at 259 (para 159).
[111] Ibid at 261 (para 168).
[112] Ibid at 264 (para 185).
[113] Ibid.

negotiate further".[114] The court adopted the following passage from the judgment of Millett LJ in *Little v Courage Ltd*:[115]

> "An undertaking to use one's best endeavours to obtain planning permission or an export licence is sufficiently certain and is capable of being enforced: an undertaking to use one's best endeavours to agree, however, is no different from an undertaking to agree, to try to agree, or to negotiate with a view to reaching agreement; all are equally uncertain and incapable of giving rise to an enforceable legal obligation."

The court then continued:[116]

> "The end in view (the full agreement) is insufficiently precise for the Court to be able to spell out what the parties must do in exercising their reasonable endeavours. Where the objective and the steps needing to be taken to attain it are able to be prescribed by the Court, a best endeavours or reasonable endeavours obligation will be enforceable. That may be possible in relation to some contractual negotiations of relative simplicity and predictability (*Coal Cliff Collieries* [*Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1]). But a negotiation of complex contractual terms is such a variable matter, both in process and in result, and so dependent on the individual positions which each party may reasonably take from time to time during the bargaining, that it is impossible for a Court to define for them what they ought to have done in order to reach agreement. The Court neither knows the result nor is able to say how each offer should have been made, nor whether it should have been accepted. If ECNZ had sat on its hands and absolutely declined to bargain – which was not the case – it would have been necessary, in order to provide a remedy to be able to state what, as a minimum, it was obliged to do as part of the bargaining process. That may have been possible, as can be seen from the presumption for good faith bargaining now to be found in s 32 of the Employment Relations Act 2000 and the code promulgated pursuant to s 35 of that Act, but in fact ECNZ did actively participate in a lengthy bargaining process.
>
> We take one item at random – the extension of the force majeure clause to the national grid. Did FCE have to agree to it? If so, on what terms? And if FCE was obliged to come to terms on this item, could it seek in return a price adjustment, and by how much? We have no idea how a Court could resolve these questions – by what standards they would be considered and how value would be attributed to the particular covenant which a party might be seeking. A meaning can, with some trouble, be given to

[114] [2002] 2 NZLR 433 at 458 (para 114).
[115] (1994) 70 P & CR 469 at 476.
[116] [2002] 2 NZLR 433 at 458-459 (paras 115-117).

'economic', but the task of assessing the parties' performance during a negotiation of this kind and determining whether a position taken by one side – perhaps influenced by the current position of the other – was or was not consistent with 'reasonable endeavours', is beyond the expertise of the Court. In *Coal Cliff Collieries,* notwithstanding Kirby P's view that some contracts to negotiate in good faith may be enforceable, he expressed his conclusion that a Court would be extremely ill-equipped 'to fill the remaining blank spaces' which a lengthy negotiation between the parties to a mining contract had failed to remove. He pointed out that the Court could not appeal to objective standards or its own experience. At stake were commercial decisions 'involving adjustments which would contemplate binding the parties for years and deciding issues that lie well beyond the expertise of the court'. How mining executives, attending to the interests of their corporation and its shareholders, might act in negotiating such a complex transaction was 'quite unknowable' (p 27). Those remarks are entirely apposite to the present case.

As we do not know what ECNZ was obliged to do towards a full agreement, we are unable to say that it in fact acted unreasonably in circumstances where the HoA was not legally binding and where ECNZ was entitled to seek a firm supply of gas until 2017. Notably FCE did not complain until well afterward. FCE also faces the difficulty that bargaining continued for much longer than three months."

In my view, this reasoning, which could easily be the subject of an article in itself, is unsatisfactory. There is only space for a few brief observations here.

First, the conclusion is inconsistent with House of Lords, Privy Council and other authority. In *Walford v Miles*[117] the House of Lords, while refusing to recognise an agreement to negotiate in good faith, accepted that an agreement to use best endeavours to agree was enforceable.[118] In *Queensland Electricity Generating Board v New Hope Collieries Pty Ltd*[119] the Privy Council was prepared to *imply* an obligation to use reasonable endeavours to agree on the terms for the renewal of a supply contract. There is also substantial American authority to like effect.[120] The notion that a reasonable endeavours clause contained in an otherwise binding HoA was not enforceable would, I believe, be greeted with incredulity there.

[117] [1992] 2 AC 128 at 138.

[118] In *FCE v ECNZ* the Court of Appeal equated "all reasonable endeavours" with "best endeavours". The relevant section of the unreported judgment is headed "The best endeavours obligation". But see now [2002] 2 NZLR 433 at 458 (heading changed to "The 'all reasonable endeavours' obligation").

[119] [1989] 1 Lloyd's Rep 205 at 210.

[120] See *Farnsworth on Contracts* (Little Brown and Co, Boston, 1990), vol 1, paras 3.26-3.26(c).

Secondly, too much weight was placed on "the nature of the 'not agreed' terms" and the difficulties facing a court in seeking to determine what ought to have been agreed. One can accept that "a Court would be extremely ill-equipped 'to fill the remaining blank spaces' which a lengthy negotiation between the parties to a mining contract had failed to remove". However, an agreement to negotiate or to use reasonable endeavours does not oblige the parties actually to reach an agreement. "Its target is the process of the negotiations, not the end result."[121] What the parties must do to satisfy a reasonable endeavours obligation will depend on the circumstances of each case, but usually there will be no question of the court having to choose between "individual positions which each party may reasonably take from time to time during the bargaining" and "defin[ing] for them what they ought to have done in order to reach agreement". Particularly important in a case like *FCE v ECNZ* will be whether the HoA containing the agreement to negotiate was itself a binding supply contract. If it was, the parties' obligation would be to use reasonable endeavours to convert *that agreement* into a "full agreement". Refusing to modify previously agreed terms or to add previously unagreed terms is unlikely to be unreasonable behaviour. Indeed, Wild J found that ECNZ was in breach mainly because its negotiators were insisting upon departures from the HoA. Viewed in that light, and bearing in mind that the Court of Appeal was considering the reasonable endeavours clause on the assumption that the HoA *was* binding, the discussion of "the one item at random – the extension of the force majeure clause to the national grid" is misconceived. There was no question of a court having to determine whether FCE had to agree to it and, if so, on what terms, etc.

Like Kirby P in *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd*[122] the court at times seems to fall into the trap of attempting to assess the certainty of the agreement to negotiate by concentrating on the ability of a court to complete the agreement being negotiated. The promisee is not seeking to enforce an obligation to carry out the transaction being negotiated so, of course, there is no question of the court having to complete that transaction by supplying the missing terms. As I have pointed out elsewhere,[123] in the case of an alleged contract to negotiate, the agreement is not incomplete. The only problem is to determine what is the content of the obligation in the particular circumstances of the case.

It remains to note Thomas J's disdainful rejection of the majority's conclusion. His Honour said:[124]

[121] N Cohen, "Pre-contractual Duties: Two Freedoms and the Contract to Negotiate" in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (1995) 25 at 37.
[122] (1991) 24 NSWLR 1 at 25-27.
[123] D W McLauchlan, "Rethinking Agreements to Agree" (1998) 18 NZULR 77 at 97-98.
[124] [2002] 2 NZLR 433 at 490 (paras 243-244).

"I utterly reject the majority's finding that, even if the all reasonable endeavours clause were part of the binding HoA, because of the nature of the 'not agreed' items, it would be difficult to see that the clause could create any legal obligation to negotiate further … To me, the notion, assuming that the HoA is binding, that either party could have legally declined to undertake any negotiations directed to completing the full agreement is disturbing. If that is the law it is an ass.

To my mind, once the HoA was completed, the parties were obliged to negotiate in good faith. Neither party could sit on its hands and decline to negotiate or fail to negotiate in good faith. To decline to negotiate or to negotiate in bad faith (or other than in good faith) would be a breach of that obligation. Essentially, this is Wild J's finding, and I cannot fault it."

CONCLUSION

The outcome of disputes over the enforceability of preliminary agreements is notoriously difficult to predict. This is perhaps inevitable because each case turns on its own facts and relatively small shifts in circumstances can easily affect the result.[125] Nevertheless, as this paper has demonstrated, there have been occasions when the outcome has been substantially affected not only by different understandings of the applicable legal principles but also different judicial perceptions of what lay persons or business people regard as binding commitments.

The foregoing review of recent developments concerning the legal status of HoA suggests that, the decision in *FCE v ECNZ* notwithstanding, the courts nowadays see fewer obstacles to their enforcement than they once did. The critical question in each case will be: did the parties intend to be bound? If the answer to that question is yes, the agreement will be enforced provided that the areas of incompleteness or uncertainty do not render it "unworkable". And the agreement will be workable if there is a sufficient skeleton of express terms which, when supplemented by reasonable implications, render it capable of enforcement.[126] Most importantly, the fact that matters have been reserved for future agreement between

[125] See further D W McLauchlan, "Informal Agreements for the Sale or Lease of Land: When are they Contracts?" [1993] NZ Recent L Rev 442 and "'We have a Deal' – Mere Consensus or Concluded Bargain?" (1996) 2 NZBLQ 205.

[126] Barrett J expressed essentially the same idea in *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886; (2002) 18 BCL 57 at 64 (para 35). when he said that the terms of the HoA not affected by the elements of incompleteness must be "sufficiently cohesive and coherent to stand as a contract in their own right".

the parties will no longer make it void for incompleteness. Moreover, mere ambiguity is not to be equated with uncertainty. To justify finding an agreement void for uncertainty the language used to define the parties' central obligations must be "so obscure and so incapable of any definite or precise meaning that the court is unable to attribute to the parties any particular contractual intention".[127]

So far as *FCE v ECNZ* is concerned, there are lessons to be learned from the case for those who elect to use HoA to conclude important commercial transactions. First, they should obviously not mark unagreed terms as "not agreed", at least if they wish to avoid the risk of the agreement being held to be unenforceable. Such terms should be deleted from the document altogether or crossed out and initialled. Secondly, and more importantly, if the HoA, or indeed are not, intended to be binding until replaced by the anticipated full agreement, a clause to that effect should be included in the document.[128] Signatures coupled with the customary hand-shakes, or even celebratory drinks,[129] cannot be relied on. Although the courts accept that their task is to ensure that "the dealings of men may as far as possible be treated as effective, and that the law may not incur the reproach of being the destroyer of bargains",[130] they cannot always be trusted to do so. It is conceded that cases in this area often "afford room for much legitimate difference of opinion",[131] but I find it difficult to accept that *FCE v ECNZ* falls into that category. Be that as it may, there is an easy means of avoiding the potential for such costly law suits.

Of course, this is only practical advice where the parties have formed a definite intention either way. In my experience, Thomas J's "deal-makers" tend not to turn their minds to such niceties and, if they do, they are remarkably ambivalent. Yes, if all goes well they intend the agreement to be binding, but if the deal turns sour they expect there to be a way out. So why not let the lawyers argue that there were too many outstanding issues for the parties to have intended legal commitments? Commercial expediency drives their attitudes and conduct. Indeed, it is perhaps not too cynical to suggest that if in *FCE v ECNZ* market conditions had moved adversely to FCE, it would have been that company, not ECNZ, arguing that the HoA was not a binding contract.

[127] *G Scammell & Nephew Ltd v Ouston* [1941] AC 251 at 268 per Lord Wright.

[128] As in, eg, *Telstra Corporation Ltd v Australis Media Holdings Pty Ltd* (1997) 24 ACSR 55 and *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886; (2002) 18 BCL 57.

[129] See D W McLauchlan, "'We have a Deal' – Mere Consensus or Concluded Bargain?" (1996) 2 NZBLQ 205.

[130] *Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503 at 512 per Lord Tomlin.

[131] Ibid.

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