Contract Law
Avoiding legal risk with MOUs, heads of agreement, informal, and preliminary, agreements
by John K. Arthur

Introduction:
1. Heads of agreement and memorandum of understanding, as well as letters of intent and letters of comfort are types of preliminary (or informal) agreements. Depending on the circumstances, they may be legally binding and promissory, or otherwise merely representational, and not binding. Preliminary agreements are one of the most commonly litigated matters in this country. This paper will

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2 See Kleinwort Benson Ltd v Malaysia Mining [1989] 1 WLR 379 at 391 where a letter of comfort is described as a document under which one party would give comfort to the other party by assuming not a legal liability to ensure repayment of the liabilities of its subsidiary but a moral responsibility.

3 Such agreements are referred to as preliminary agreements in J Tarrant, “Preliminary Agreements“ (2006) 3 UNEJ 151, and DW McLauchlan, In Defence of the Fourth Category of Preliminary Agreements: Or are there only two? (2005) 21 JCL 286 but also as “informal agreements”, see, A. Monichino SC, But we agreed! (2007) 81 LJ 52. There seems to be little distinction between heads of agreement, memorandums of understanding and letters of intent (Letters of Intent and other pre-contractual documents, Lake & Draetta, B/worths, 1989, p 4). Each may be binding or non-binding depending on the circumstances. In Maroubra Pty Ltd v Murchison Queen Pty Ltd [2002] WASC 98 Hasluck J found that a MoU in relation to the transfer of a mining lease was a legally enforceable agreement as it contemplated the “mine” to be conveyed for a specified price. His Honour was influenced by the fact that payment of an amount due under the agreement was made. It was noted that where an agreement is made in a commercial context which contains clearly defined terms of a promissory nature supported by consideration, there is a strong presumption that the agreement was intended to be legally enforceable relying on Edwards v Skyways Ltd [1964] 1 WLR 349. There is no presumption that preliminary agreements are binding or non-binding: ibid, Ermogenous at 106; Toyota Motor Corp v Ken Morgan Motors [1994] 2 VR 106 at 177 where Tadgell J stated with much force that “there can be no presumption of an intention to make a promise” of contracts for the sale of land: Marek v Australasian Conference Assn P/L [1994] 2 Qd R 521 at 527; ibid, GR Securities 40 NSWLR at 634; substantial commercial transactions: RT & YE Falls Investments P/L v State of NSW [2001] NSWSC 1027 per Palmer J

consider the utility of preliminary agreements, the sorts of problems that may arise from their use, how the law determines whether they are binding, as well as points to consider when drawing such agreements.

**Why use preliminary agreements:**

2. Preliminary agreements are used in a variety of commercial and legal contexts. They are commonly utilized where for one reason or another the parties wish to enter into an interim or initial agreement or understanding prior to, and in anticipation of, the making a formal contract which will properly and fully record their mutual rights and obligations. The document may or may not be intended to be binding. In some situations a preliminary agreement will not be intended to create binding contractual relations, but rather be intended as a ‘declaration of purpose’ to secure a moral commitment from prospective business partners or venturers. The parties’ intentions may be to protect themselves by suitable words from being bound by their negotiations. The parties may include a confidentiality clause to aid negotiation without disclosing commercial secrets, even if no binding contractual arrangements are entered into. In this sort of situation, while no binding contractual arrangements are intended, the binding nature of the confidentiality clause is required. A negotiation may have reached a point where the parties wish to record their agreement to that point, despite other points remaining at issue. A preliminary agreement may give the parties comfort and impetus to move towards concluding their bargain.

3. Preliminary agreements have proven a useful tool in commercial life for lawyers and business people alike. Used sensibly they will assist commercial parties in reaching, and recording, a preliminary consensus, but used badly, or in an haphazard or ill-informed fashion, they can create difficulties. If the parties are ambivalent or ambiguous in their communications, and unless great care is taken to properly record the parties’ true intentions (and even if this occurs), a risk of difficulty and dispute may arise.

4. The cases are legion in which the binding nature of preliminary agreements is at issue. One academic suggests that disputes about the enforceability of preliminary

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5 ibid, TLA at [24.03.106]. They may be used so that the parties feel “bound” to a greater degree by a signed piece of paper, the longer the parties wait to record their oral understandings in writing, the increased risk of misunderstandings arising; if the terms of the proposed transaction are complicated such an agreement may give each party comfort that a meeting of the minds has taken place; the letter might convince a third party, or someone within the organisation or a financier that the contemplated deal is viable; and it may serve as an aide memoire for the draftsperson who will draft the formal contract: see, “Letters of Intent – Are they worth it”, R Macey, (2004) 78 LJ (No 3) 60-63; and see Confidential and Commissioner of Taxation [2013] AATA 76 per Senior Member E. Fice at [26] (which case was kindly referred to me by Andrew Wilson of Aitken Partners, Solicitors, Melbourne). See notes 7 and 22 below.

6 Masters v Cameron (1954) 91 CLR 353; 363

7 See eg. ibid, Confidential and Commissioner of Taxation at [28]

8 See, J Tarrant, Preliminary Agreements (2006) 3 UNELJ 151 at 155-156

9 ibid

10 It is suggested that the letter of intent or heads of agreement is the preferred option for international joint venturers in the negotiation phase by which a statement of operating principles between the participants is obtained which is subsequently supplemented by a detailed joint venture agreement, The Laws of Australia, Thomson (TLA) at [24.03.106]
commercial agreements are second only to interpretation disputes as the most litigated cases in Australia and New Zealand. It may be queried whether parties would be better off waiting for a short period for their lawyers to draw a more formal document which properly records their intentions, rather than utilizing a preliminary agreement unaided by proper legal advice and assistance. Commercially however, the parties may purposefully wish to leave the preliminary agreement vague, ambivalent or ambiguous so that each has an “out” or an “in” depending on what subsequently occurs. The resolution of such ambiguity may require detailed factual and legal analysis.

Problems may arise if the parties’ intentions are not made clear:

5. The true nature of a preliminary agreement and whether or not it is intended to constitute a concluded and binding contract is critical. A variety of problems can arise if the parties’ intentions are not made perfectly clear.

Australian Securities and Investments Commission v Fortescue Metals Group Ltd:

6. In the well known recent case of Forrest v Australian Securities and Investments Commission the High Court overturned the decision of the Full Federal Court in Australian Securities and Investments Commission (ASIC) v Fortescue Metals Group Ltd (FMG), which had found that FMG had engaged in misleading and deceptive conduct under s. 52 Trade Practices Act 1974 (Cth) and s. 1041H Corporations Act 2001 (Cth) (and FMG’s chairman and CEO was a person involved in the contravention), in making various public announcements that FMG had executed binding agreements with Chinese contractors to build, finance and transfer the infrastructure for a mining project in the Pilbara in Western Australia. The Full Federal Court had found that the framework agreements were merely ‘agreements to agree’ with many crucial matters left to be worked out between the parties. While the subjective intentions of the parties may have been to enter into a binding agreement to build the infrastructure, the crucial question was whether such a contract was actually made which involved taking an objective view of the agreement. The contents of the agreements as to subject matter, scheduling and price were expressly left to be agreed, such that the agreements

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11 DW McLauchlan, In Defence of the Fourth Category of Preliminary Agreements: Or are there only two? (2005) 21 JCL 286, p 287
12 Ibid, Tarrant at p. 156
16 Now s. 18 Australian Consumer Law which is Sched. 2 to the Competition and Consumer Act 2010 (Cth.) which is what the Trade Practices Act 1974 (Cth.) has been renamed.
17 As a result it was found that FMG had contravened as well the continuous disclosure requirements of s. 674 Corporations Act and Mr Forrest had not exercised his powers or discharged his duties as a director of FMG with the care and diligence required under s. 180(1) Corporations Act.
18 Keane CJ at FCR 409
19 By the express terms of the framework agreements, the parties would seek to reach agreement on these matters: ibid Keane CJ at 411
contemplated the execution of further agreements and were not considered objectively binding.

7. The majority in the High Court\(^{20}\) held that the impugned statements were not misleading or deceptive or likely to mislead or deceive, and as such the other allegations that ASIC made\(^{21}\) dropped away as well. The impugned statements conveyed to the intended audience (that is, both present and possible future investors, or perhaps a wider section of the commercial or business or commercial community) what the parties to the agreements understood that they had done and intended would happen in the future – specifically that the parties had made agreements and what the parties to the framework agreements had said in those agreements and that those parties intended their agreements to be legally binding. Heydon J held that the impugned statement about the contract being binding was a statement of opinion rather than fact and ASIC failed because it did not establish that FMG did not genuinely and reasonably hold that opinion.

8. The context within which these cases arose were not strictly *inter partes* litigation with one party seeking to enforce a preliminary agreement against the other, but in the ASIV v FMG case a prosecution brought by ASIC pursuant to the *Corporations Act* acting under its statutory powers alleging that FMG and its chairman and CEO had engaged in misleading and deceptive conduct, and other infractions of the *Corporations Act*. It may be suggested that necessarily different questions may arise depending on the context\(^{22}\). In the following case the context was quite different.

*Newtronics Pty Ltd (recs & mgrs appd) (in liq) v Atco Controls Pty Ltd (in liq) & Ors; Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (recs & mgrs apptd) (in liq)*:

9. In another case a letter of comfort or support was given by one company (Atco) in relation to its subsidiary (Newtronics) to the effect that Atco would not call up the amount owing by Newtronics to Atco and if necessary funds or additional bank security would be provided to Newtronics or its financier to ensure that it could meet its current trading obligations that had or would be incurred. The primary judge held that the terms of a binding and enforceable contract could be found in the letters of support and gave judgment for Newtronics against Atco\(^{23}\). The primary judge’s decision was overturned on appeal\(^{24}\), the Court of Appeal holding that a non-binding commercial arrangement, rather than a legally binding agreement existed. The acid test was – “whether viewed as a whole and objectively from the point of view of reasonable persons on both sides, the

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\(^{20}\) French CJ, Gummow, Hayne and Kiefel JJ

\(^{21}\) As referred to in note 12

\(^{22}\) See ibid, *Confidential and Commissioner of Taxation* at [13] which related to when a taxpayer vendor of a business disposed of a CGT asset comprising his interest in the business. The Commissioner asserted that this occurred when taxpayer, as vendor of the business, entered into heads of agreement with the purchaser of the business. The Tribunal agreed holding that a disposal of the taxpayer’s CGT asset being its interest in the business occurred at that time. Relevantly the Tribunal pointed out at [[13]] that it did not have any evidence from the purchaser of the business.

\(^{23}\) *Newtronics Pty Ltd (recs & mgrs appd) (in liq) v Atco Controls Pty Ltd (in liq) & Ors* [2008] VSC 566

\(^{24}\) in *Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (recs & mgrs apptd) (in liq)* [2009] VSCA 238
dealings show a concluded bargain”. There was no intention to create legal relations and the support was never intended to be legally binding. There was an absence of good consideration and a debenture by Newtonics in favour of Atco was inconsistent with the binding agreement to be inferred.

**Whether the preliminary agreement is binding:**

10. A critical question which arises in cases where the parties have decided to enter into a preliminary agreement before entering into a formal contract will be whether the preliminary agreement is a binding contractual arrangement. The intention to enter into such an agreement is the “decisive issue”. The determination of this issue may be articulated as: *did the parties reach a consensus? If they did, was it capable of forming a binding contract? If it was, did the parties intend it to constitute a binding contract?* Such intention will be objectively ascertained having regard to the communications between the parties and the circumstances in which they took place.

11. According to one commentator, in modern times the Courts have been more likely to seek to fill in gaps in preliminary agreements so that they may be enforced but will not fill in gaps in incomplete agreements, or where the gap is too wide to be filled. It is clear that an incomplete agreement or a mere agreement to agree is not legally enforceable, nor is an agreement to negotiate, at least unless it is clearly and unequivocally expressed. The Courts will strive to uphold bargains and to that end will be inclined to construe the terms of an agreement, by applying objective standards of reasonableness and express machinery, and implying terms to give efficacy to the bargain, to give effect to the

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25 Vroon BV v Fosters Brewing Group Ltd [1994] 2 VR 32 per Ormiston J at p. 81 referring to what was said by Cooke J in *Meates v AG* [1983] NZLR 308, 377 (referred to in Atco at [34]

26 Atco at [57]-[58]

27 *GR Securities P/L v Baulkham Hills Private Hospital P/L* (1986) 40 NSWLR 631 at 634E cited in *Bagot v Chameleon Mining NL* [2012] NSWSC 1331 at [57]

28 Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd (1985) 2 NSWLR 309 at 326G referred to in Bagot, ibid as “a convenient template” at [61]

29 *GR Securities* (ibid) at p. 634; *Brambles Holdings v Bathurst City Council* [2001] NSWCA 61; [2001] 53 NSWLR 153 at [25] per Heydon JA; *ABC v IVTH Commonwealth Games Ltd* [1988] 18 NSWLR 540 Gleeson CJ (Hope and Mahoney JJA agreeing) at pp 548-549; *Gulfoyle Developments Pty Ltd v Geoffrey Craig Frumar* [2012] NSWSC 859 at [46]-[47]; *Ermogenous v Greek Orthodox Community of SA Inc* (2002) 209 CLR 95 at [25]. Whether or not a preliminary agreement or any other contract constitutes a binding contract is a question of fact and the plaintiff has the burden of persuading the court that such an agreement exists:

- *Booker Industries P/L v Wilson Parking (QLD) P/L* (1982) 149 CLR 600 at 604 recently cited in *Factory 5 Pty Ltd (In Liq) v State of Victoria (No 2)* [2012] FCAF 150 at [60]; ibid, J Tarrant at p. 183 citing Kirby P in *Coal Cliff Collieries*, ibid at p. 20: “Courts are not well equipped, drawing on their own experience, to fill out the detail of such contracts where the parties leave gaps in their own agreement ...Courts cannot enforce such agreements because they are incapable of judging where the negotiation on particular points would have taken the parties”. *Incomplete* agreements mean that essential terms are lacking

31 *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand* [2002] 2 NZLR 433 at 447; see J Tarrant at pp 184-185


parties’ intentions even if that intention has been obscurely expressed\textsuperscript{34}. In a suitable case an estoppel by conduct may be able to be relied upon precluding denial of the contract’s existence\textsuperscript{35}, or where there is no contract in existence, restitutory or other remedies may still be available\textsuperscript{36}.

**Court’s approach to determining whether preliminary agreement binding - completeness, certainty and intention to be bound**

12. The approach taken by the Courts to determine whether a preliminary agreement constitutes a binding contractual arrangement is two-fold\textsuperscript{37}: first, whether, as a matter of construction, the alleged agreement constitutes a binding contract, or only a basis for negotiation of a contract; and secondly, whether the parties intended to be immediately bound by the terms agreed. The question is whether “viewed as a whole and objectively from the point of view of reasonable persons on both sides, the dealings show a concluded bargain”\textsuperscript{38}.

13. The first issue to be determined is whether there has been a “voluntary assumption of a legally enforceable duty” (which is the essence of contract)\textsuperscript{39}. For such a duty to arise all the essentials for a contract in the particular case must be present, including, that the parties must be identified, the terms must be certain, and there must generally be consideration\textsuperscript{40}. Yet despite the existence of these matters, the circumstances may show that the parties did not intend or cannot be regarded as having intended for their agreement to be binding\textsuperscript{41}.

14. In determining the second issue, “intention”, as has been noted is the case generally in contractual contexts, is determined in the sense that “(i)t describes

\textsuperscript{34} Fortescue Metals at [121]-[123] per Keane CJ. Courts may be more willing to uphold preliminary or informal agreements to settle litigation: See A. Monichino SC, But we agreed! (2007) 81 LJI 52
\textsuperscript{35} Thompson v Palmer [1933] HCA61; (1933) 49 CLR 507; 546-7 per Dixon J; Grundt v Great Boulder Pty Gold Mines [1937] HCA 58; (1937) 59 CLR 641 at 656-7 per Latham CJ; 674-6 per Dixon J; PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd (2007) 20 VR 487; [2007] VSCA 310 per Nettle JA at [7]; in Skilled Group Ltd v CSR Viridian Pty Ltd [2012] VSC 290 at [173]-[175] per Vickery adopting Nettle JA’s approach in PRA Electrical (obiter as it had been held that the subcontracts in issue were in existence)
\textsuperscript{36} Pavey & Matthews v Paul (1987) 162 CLR 221; 256; Sabemo Pty Ltd v North Sydney Municipal Council [1977] 2 NSWL 880 Angelopoulos and Anor v Sabatino and Anor (1995-6) 65 SASR 1; Andrew Shelton & Co Pty Ltd v Alpha Healthcare Ltd [2002] VSC 248 at [95–107]; ibid, Skilled Group Ltd at [178]. Remedies under s. 18 Australian Consumer Law may be available.
\textsuperscript{37} Masters v Cameron (1954) 91 CLR 353; 360
\textsuperscript{39} Ermogenous v Greek Orthodox Community of SA Inc [2002] 209 CLR 95 at [24]; [2002] HCA 8; 76 ALJR 465; 187 ALR 92; Maroubra Pty Ltd v Murchison Queen Pty Ltd [2002] WASC 98 at [59]
\textsuperscript{40} unless the agreement is recorded as a deed: Ermogenous at [24]; see Skilled Group Ltd v CSR Viridian Pty Ltd [2012] VSC 290 at [165] where Vickery J stated that generally only three matters are regarded as essential, viz agreement on parties, subject matter and consideration and price but other matters may also be regarded as essential in the circumstances of the case
\textsuperscript{41} ibid, Ermogenous at [25]
what it is that would objectively be conveyed by what was said or done, having
regard to the circumstances in which those statements and actions happened”42.

15. In Masters v Cameron43, the locus classicus in relation to the enforceability of
preliminary agreements, the High Court identified three categories of preliminary
agreements. To these may be added a fourth category identified in Sinclair’s
case44 and resurrected by McLelland J in Baulkham Hills Private Hospital Pty Ltd v
GR Securities Pty Ltd45 and now also universally accepted.

16. In Masters v Cameron, in a passage which has been influential in Australian
jurisprudence, the majority identified three categories of preliminary agreement
where the parties who had been negotiating achieve agreement upon terms of a
contractual nature agreeing that the subject of their negotiation should be dealt
with by a formal contract, as follows (material in parenthesis added)46:

1) 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. (binding)

2) 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. (binding but
performance of terms conditional upon execution of formal contract)

3) 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. (not binding)

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

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42 ibid, Ermogenous at CLR pp105-6

43 Masters v Cameron (1954) 91 CLR 353; (1954) 28 ALJR 438. The facts were that by a document a vendor
agreed to sell farming land to a purchaser “subject to the preparation of a formal contract of sale which
shall be acceptable to my solicitors on the above terms and conditions” and the purchaser agreed to
purchase the property “on the above terms and conditions”. It was held that the document did not
constitute a binding contract. The Court looked at the authorities which showed that “subject to contract”
makes it clear that neither of the parties is to be contractually bound until a contract is signed. Although
the formal contract was to be “on the above terms and conditions” it was to be acceptable to the vendor’s
solicitors, meaning not only those terms already stated but whatever else the solicitors thought
appropriate. The document was not binding

44 Sinclair Scott & Co Ltd v Naughton (1929) 43 CLR 310

45 (1986) 40 NSWLR 622 at 628 where the words “agreement in principle” did not prevail over the clear
import of the words “legally binding”, which case was affirmed on appeal in GR Securities Pty Ltd v
Baulkham Hills Private Hospital Pty Ltd (1986) 40 NSWLR 631

46 at 360-362
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\(^\text{47}\) 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 formal document ... or simply because they wish to reserve to themselves a right to withdraw at any time until the formal document is signed.

17. A fourth category identified is where the parties are “content to be bound immediately and exclusively by the terms which they have agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms”\(^\text{48}\). Again, into which category an agreement will fall will depend on the intention of the parties objectively ascertained\(^\text{49}\).

18. One academic has suggested that there are in fact only two categories of cases, and the law would be easier to understand if this was recognised\(^\text{50}\). Those categories are first, agreements which are intended to be binding and are sufficiently complete (the current first, second and fourth categories), and agreements which are not intended to be binding or that are not sufficiently complete (which is the current third category).

\(^{47}\) eg ibid, Factory 5 P/L (in liq) at [104](k) per Foster J

\(^{48}\) Sinclair, Scott & Co Ltd v Naughton (1929) 43 CLR 310 at 317 per Knox CJ, Rich and Dixon JJ; the fourth category was restated by McLelland J in Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd (1986) 40 NSWLR 622 at 628 and affirmed on appeal in GR Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd (1986) 40 NSWLR 631; also referred to in ibid, Tarrant at 157-158 and referring to Peden, Carter and Tolhurst When Three Just Isn’t Enough: the Fourth Category of the ‘Subject to Contract Cases’ (2004) 20 JCL 156, Young CJ in Helmos Enterprises Pty Ltd v Jaylor Pty Ltd Helmos Enterprises Pty Ltd v Jaylor Pty Ltd (2005) 12 BPR 23,021; (2005) Aust Contract R 90-215; [2005] NSWCA 235 stated at [69] that “an article by academics which attacks the considered view of MH McLelland J, one of the greatest equity judges of the 20th century, in a decision which was upheld in the Court of Appeal and since followed by almost every judge of the Court of Appeal and the Equity Division, as not being of any authority and contrary to what the High Court said in Masters v Cameron, does not rate serious consideration”. See also ibid, DW McLachlan which discusses this issue. In Skilled Group Ltd v CSR Viridian Pty Ltd [2012] VSC 290 at [106]-[107], [117] Vickery J held that the parties in that case had reached an agreement in the nature of the fourth category of preliminary agreement. In Uranium Equities Ltd v Fewster (2008) 36 WAR 97; [2008] WASCA 33 at [129] stated that the fourth category is a variation of the first category

\(^{49}\) Masters v Cameron at 362

\(^{50}\) ibid, DW McLauchlan
The factors for determining whether a preliminary agreement is binding:

If the enforceability of a preliminary agreement is at issue, what are the determinative factors? It is suggested the main factors in determining whether a preliminary agreement is binding are as follows:

(a) the parties must intend in entering the preliminary agreement to be immediately bound pending execution of the anticipated formal contract. Such intention is to be ascertained objectively by “consider(ing) what reasonable persons in the position of the parties would have understood to mean by reference to the text of the agreement, the surrounding circumstances known to the parties and the purpose or object of the transaction”;

(b) the main factor to consider is the language used by the parties in the agreement for if this is clear and conclusive, the court may not need to look further. If the language is ambiguous, then the other factors referred to in (c)-(f) below will be relevant;

(c) the presence of elements of uncertainty or incompleteness in the agreement may indicate that the parties did not intend to be bound but this is not conclusive and the parties may intend to be bound notwithstanding there are gaps in what has been agreed, or that additional terms are needed. However uncertainty or incompleteness must not render the agreement unworkable. There must be sufficient express terms

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51 Adapted, and derived, from the suggested summary of the main principles in DW McLachlan ibid at p. 305, as well as the cases including Fortescue Metals at [121]-[123], [131]-[132] per Keane CJ and those noted
52 Everest Project Developments Pty Ltd v Mendoza & Ors [2008] VSC 366 per Hargrave J at [65] and cases there cited including Pacific Carriers Ltd v BNP Paribas [2004] HCA 35; [2004] 218 CLR 451, [22]; Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd [2004] HCA 52; [2004] 219 CLR 165, [40].
53 ibid, J Tarrant at p. 164; in Malaga Pty Ltd v AW Engineering P/L [2012] NSWCA 227 at [23];[24] the Court of Appeal (per Macfarlan JA) agreed with the trial judge that the words “without affecting the binding nature of these heads of agreement” were decisive in revealing the intention of the parties to be bound; in Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd (1986) 40 NSWLR 622 at 628 McLelland J decided that the words “agreement in principle” did not prevail over the clear import of the words “legally binding”. Kirby P took a similar view in Coal Cliff Collieries v Sijehama (1991) 24 NSWLR 1 at p. 21; see also Anaconda, ibid per Ipp J at 114; and Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand [2002] 2 NZLR 433 referred to in J Tarrant, ibid, at pp 166-168. However in First Church of Christ Scientist v Ormlie Trading P/L [2003] QSC 351 an offer and acceptance “in principle” for the sale and purchase a property for a specified price was held not to amount to a binding contract as it demonstrated a cautious approach by both parties (at [28]). In ibid Everest Hargrave J stated at [65] “(t)he Court should have regard to all of the words used in the agreement “so as to render them all harmonious with one another” and to ensure the “congruent operation of the various components as a whole” (citing ABC v Australasian Performing Right Association Ltd [1973] HCA 36; [1973] 129 CLR 99, 109; Wilkie v Gordan Runoff Ltd [2005] HCA 17; [2005] 221 CLR 522, [16]). See also Confidential and Commissioner of Taxation, ibid, at [33].
54 In ibid, Everest at [65] where Hargrave J stated at [65] “(i)n interpreting the words and resolving any ambiguity, the Court should proceed in a common sense and non-technical way and give the agreement a commercially sensible construction” (footnote omitted)
55 Ibid Tarrant at p. 174; Anaconda at p. 110
to be supplemented by reasonable implication of necessary terms, or by resort to considerations of reasonableness to render the agreement enforceable;

(d) the more numerous and significant the areas in respect of which the parties have failed to reach agreement, or which are incomplete (or uncertain), the less willing will be a court to conclude that the parties had the requisite contractual intention;

(e) the magnitude, subject matter or complexities of the transaction may show that the preliminary agreement was not intended to have legal effect but these factors will give way to the parties’ express intention to be bound immediately;

(f) the particular surrounding circumstances, including relevant and contemporaneous correspondence, whether there has been partial performance of the alleged agreement, the subsequent conduct of the parties, any prior dealings and any trade practice or custom, and the nature of the relationship between the parties.

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57 ABC v XIVth Commonwealth Games Ltd [1988] 18 NSWLR 540 at 548 per Gleeson CJ
58 Geelong Investments P/L v Varga Group Investments No 8 P/L (1995) 7 BPR 14,551, 14,569-70 per Kirby P; BC9505503; ibid, Tarrant at p. 163 citing inter alia, Anaconda, ibid, at 110 per Lpp J
60 Fortescue Metals at [121]-[123], [131]-[132] per Keane CJ at [131]; Toyota Motor Corp v Ken Morgan Motors [1994] 2 VR 106 at p. 131. The inference that the preliminary agreement is not to be binding will be drawn where it is usual for parties to execute a formal agreement such as in a sale of land or business, or even a lease: TLA [7.1.270] citing Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd (1985) 2 NSWLR 309 where the Court of Appeal held that the document headed “Terms of Agreement” was intended to be a binding agreement. TLA suggest the case contains a useful discussion of the test of intention and of admissible evidence; and see Landsmiths Pty Ltd v Hall [1999] NSWSC 735 at [9] per Young J; Long v Piper [2001] NSWCA 342 at [55]; ibid, Uranium Equities at [131] citing GR Securities P/L v Baulkham Hills, ibid, at 634-S
61 ibid, Geelong Investments, BC9505503 at 38-40; ibid, J Tarrant citing GR Securities v Baulkham Hills Private Hospital (ibid) at p. 634 per McHugh J
62 Such evidence is allowed as an exception to the parol evidence rule, as the evidence goes not to what are the terms of the contract but whether there is a contract at all, see Factory 5 P/L (in liq) at para [104][k] per Foster J
63 which may show how far the parties were apart from achieving a real consensus: Australian Securities and Investments Commission (ASIC) v Fortescue Metals Group Ltd [2011] 190 FCR 364; [2011] 274 ALR 731; [2011] 81 ACSR 563; [2011] FCAFC 19 at [121]-[123], [131]-[132] per Keane CJ at [151]
64 Ibid, J Tarrant at p. 162; 168-9 referring to, inter alia, Anaconda Nickel Ltd v Tarmoola Australia P/L (2000) 22 WAR 101. Partial performance will be an important factor as if the agreement has been performed on both sides it will make it unrealistic to argue that there was no intention to be bound by it (ibid, J Tarrant at p. 169). See also Sudbrook Trading Estate Ltd v Eggleton [1983] 1 AC 444 at 460 per Templeman LJ where an agreement that might fail because of incompleteness, if it has been partly performed ‘the court will strain to the utmost to supply the want of certainty’
65 the subsequent difficulty parties experience in documenting the alleged agreement will amount to an indication that the parties had not reached an agreement: ibid, Factory 5 P/L (in liq) at [66] per Rares and Dodds-Streelon J; informing the court that a matter had settled rather than settled in principle and

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19. These factors may assist practitioners in drawing preliminary agreements so that they will, or will not, be binding contractual documents (depending on what their clients wish to achieve)68.

**Points to consider when drawing a preliminary agreement:**

20. When drawing, or reviewing a preliminary agreement practitioners should consider whether:

(a) the parties are properly identified;

(b) there is a statement of the transaction contemplated;

(c) there is a description of the products or services proposed to be sold or purchased (whether the subject matter is adequately identified);

(d) the consideration, or a formula for determining it is set out;

(e) there are conditions precedent or subsequent to the agreement;

(f) all the critical agreed terms are set out but no more than this69;

(g) there is a time-frame for completion;

(h) the parties’ intentions to be bound or otherwise are properly set out;

(i) there are any statements or representations which might create an expectation or encourage reliance70.

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68 As suggested in para 5 above, part of the utility of preliminary agreements in commerce might be that they have a fluidity and ambulatory quality that gives the parties ‘room to move’ and to negotiate.

69 In *Challenge Charter Pty Ltd v Curtain Bros (Qld) Pty Ltd* [2004] VSC 1 Gillard J held that neither heads of agreement, or a prior oral agreement made between the parties over the telephone in relation to the sale of a ship by the plaintiff to the defendant, were binding. The heads of agreement contained additional terms to those agreed upon orally and constituted a counter-offer which was not accepted by the Defendant. The additional terms showed that the plaintiff did not intend to be bound by the oral agreement which was in any even repudiated by the plaintiff’s insistence only to proceed on the basis of the agreement contained in the heads of agreement which was different. See A. Monichino SC, *But we agreed!* (2007) 81 LJ 52

70 adapted from ibid, R Macey
Conclusion:

21. Commercially parties will have a variety of different agendas in entering into preliminary agreements. The parties may have the best of intentions, and intend to be bound, when agreements are signed, but subsequent events may get in the way, and the greatest benefit of such agreements of informality, brevity, and expedition may end up being a distinct disadvantage. Each party may wish to have the other bound but be free to renegotiate or withdraw; one or other party may wish to be purposefully ambivalent. At other times parties may simply wish to protect themselves from being bound by their negotiations. With the complexity of commercial life, there will be a legion of other agendas and scenarios at play. It is not difficult to see how the inconsistency in expectations which preliminary agreements may involve, as well as the very benefits which they offer, have commonly led to disputes and litigation.

22. Parties should be advised to retain a legal practitioner to draw, or settle, a preliminary agreement. For practitioners it is critical in this process that the client’s intentions are achieved. This is primarily accomplished by the use of clear language which covers all critical and necessary issues. From a commercial view point of course the objects will be more various and complex.