5 June 2015

LIABILITY FOR PRE-CONTRACTUAL CONDUCT UNDER PRELIMINARY AGREEMENTS

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This paper was presented by John Arthur at the 2nd Annual Business Acquisitions Conference, Television Education Network, Gold Coast, on 5 June, 2015

Introduction

1. Preliminary agreements are one of the most commonly litigated matters in Australasia. This paper will examine the utility of preliminary agreements; how the law determines whether they are binding – binding contract or agreement to agree; the relevance of conduct and correspondence in the lead up to, and following, the preliminary agreement, non-contractual remedies, the *Archer Capital v Sage Group* case, lessons for advisers - how to avoid problems arising and tips for drafting.

Types of preliminary agreements

2. Preliminary or informal agreements[2] may take a variety of forms and be identified by various terminology, including heads of agreement,

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[2] Such agreements are referred to as preliminary agreements in J Tarrant, "Preliminary Agreements" (2006) 3 UNELJ 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 LIJ 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,

memorandums of understanding, letters of intent and letters of comfort[3]. They may be recorded in correspondence, emails[4] or even text messages[5]. Critically depending on the circumstances, they may be either legally binding and promissory, or otherwise merely representational[6] and not binding.

Utility of preliminary agreements – why use them?

3. Preliminary agreements are used in a variety of commercial and legal contexts[7]. Commonly they are 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 fully record their mutual rights and obligations. 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

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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: *Ermogenous* v *Greek Orthodox Community of SA Inc* (2002) 209 CLR 95 at 106; (2002) 187 ALR 92; (2002) 76 ALJR 465; [2002] HCA 8; BC200200663; *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" *cf* contracts for the sale of land: *Marek v Australasian Conference Assn P/L* [1994] 2 Qd R 521 at 527; *GR Securities P/L v Baulkham Hills Private Hospital P/L* (1986) 40 NSWLR at 634; substantial commercial transactions: *RT & YE Falls Investments P/L v State of NSW* [2001] NSWSC 1027 per Palmer J

[3] 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.

[4] See *Electronic Transactions Act* 1999 (CTH); *Electronic Transactions (Victoria) Act* 2000 (Vic); *Electronic Transactions Act* 2000 (NSW); *Electronic Transactions (Queensland) Act* 2001 (QLD); *Electronic Transactions Act* 2011 (WA); *Electronic Transactions Act* 2000 (SA); *Electronic Transactions Act* 2000 (TAS); *Electronic Transactions (Northern Territory) Act* (NT) 2000; *Electronic Transactions Act* 2001 (ACT); and see eg *Stuart v Hishon* [2013] NSWSC 766 and *Russells v McCardel & Ors* [2014] VSC 287 per Bell J.

[5] See *Avopiling (WA) Pty Ltd v Central Systems Pty Ltd* [2015] WASC 82

[6] *Newtronics Pty Ltd (recs & mgrs appd) (in liq) v Atco Controls Pty Ltd (in liq) & Ors* [2008] VSC 566 per Pagone J at [7] citing *Commonwealth Bank of Australia v TLI Management Pty Ltd* [1990] VR 510, 516 per Tadgell J. *Newtronics* overturned on appeal in *Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (recs & mgrs apptd) (in liq)* [2009] VSCA 238. If representational, they may create rights but *inchoate* if at all, but see paragraph 21 below.

[7] It is suggested that letters of intent or heads of agreement are 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]; and that they are "a staple part of modern M & A negotiations": "Liability for conduct in pre-contractual negotiations", Richard G Lewis, Michael Cooper, Norton Rose Fulbright, available at: http://www.nortonrosefulbright.com/knowledge/publications/109739/liability-for-conduct-in-pre-contractual-negotiations

commitment from prospective business partners or venturers[8]. 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. In certain cases the parties may include a confidentiality clause to aid negotiation without disclosing commercial secrets, even if no binding contractual arrangement is entered into. 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[9]. A preliminary agreement may give the parties comfort and impetus for them to move towards concluding their bargain[10].

Problems may arise with 'preliminary' agreements if the parties' intentions are not made clear:

4. While preliminary agreements have proven to be a useful tool in commercial life for lawyers and business people alike, if the parties are ambivalent or ambiguous in their communications, problems may easily arise. Unless great care is taken to properly and clearly record the parties' true intentions (and even if this occurs), a risk of difficulty and dispute will arise[11]. This occurred on a large scale in the case of *Archer Capital trust 4A v Sage Group* dealt with below.

5. 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 commercial agreements are second only to interpretation

[8] 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 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 LIJ (No 3) 60-63.

[9] See, J Tarrant, *Preliminary Agreements* (2006) 3 UNELJ 151 at 155-156

[10] ibid

[11] See for example, *Forrest v Australian Securities and Investments Commission*(2012) 291 ALR 399; (2012) 86 ALJR 1183; (2012) 91 ACSR 128; [2012] HCA 39, 2 October, 2012; *Newtronics Pty Ltd (recs & mgrs appd) (in liq) v Atco Controls Pty Ltd (in liq) & Ors* [2008] VSC 566; *Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (recs & mgrs apptd) (in liq)* [2009] VSCA 238

disputes as the most litigated cases in Australia and New Zealand[12]. In some situations parties would clearly be better off to wait for a short period for lawyers to draw a formal contract, rather than utilizing a preliminary agreement unaided by legal advice and assistance which may be completely unsatisfactory and lead to dispute and litigation. In other situations to wait for a formal contract may be to lose the deal, and if the initial arrangement had not been reduced to writing a party may have sought to walk away or had a change of heart. 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 subsequent events occur[13]. If this occurs, the resolution of such ambiguity may require detailed factual and legal analysis[14].

Binding contract or agreement to agree - whether the preliminary agreement is binding?

6. The true nature of a preliminary agreement and whether or not it is intended to constitute a concluded contract is critical.

7. The general approach of courts in modern times, according to one commentator, is to be more likely to seek to fill in gaps in preliminary agreements so that they may be enforced but not to fill in gaps in incomplete agreements[15], or where the gap is too wide to be filled[16]. It is clear that an incomplete agreement or a mere agreement to agree is not

[12] DW McLauchlan, *In Defence of the Fourth Category of Preliminary Agreements: Or are there only two?* (2005) 21 JCL 286, p 287
[13] ibid, Tarrant at p. 156
[14] See, *Geebung Investments P/L v Varga Group Investments No 8 P/L* (1995) Aust Contract R 90-059; (1995) 7 BPR 14,551, 14552 per Gleeson CJ cited in *Factory 5 Pty Ltd (In Liq) v State of Victoria (No 2)* [2012] FCAFC 150 at [65]
[15] *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] FCAFC 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
[16] *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand* [2002] 2 NZLR 433 at 447; see J Tarrant at pp 184-185

legally enforceable[17], nor is an agreement to negotiate, at least unless it is clearly and unequivocally expressed[18]. 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 parties' intentions even if that intention has been obscurely expressed[19].

Are the essential pre-requisites for a contract present and is there an intention to be bound?

8. The 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 or simply an agreement to agree. The intention to enter into the agreement is the "decisive issue"[20]. 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?*[21] Such intention will need to be objectively ascertained having regard to the communications between the parties and the circumstances in which they took place[22].

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[17] *Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd* (1982) 149 CLR 600 at 604; *Fortescue Metals* (2011) 190 FCR 364; (2011) 274 ALR 731; (2011) 81 ACSR 563; [2011] FCAFC 19 at [121]-[123] per Keane CJ

[18] *Fortescue Metals* (2011) 190 FCR 364; (2011) 274 ALR 731; (2011) 81 ACSR 563; [2011] FCAFC 19 at [121]-[123] per Keane CJ

[19] *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 LIJ 52

[20] *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]

[21] 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]

[22] *Brambles Holdings v Bathurst City Council* [201] NSWCA 61; (2001] 53 NSWLR 153 at [25] per Heydon JA; *ABC v XIVTH Commonwealth Games Ltd* (1988) 18 NSWLR 540 Gleeson CJ (Hope and Mahoney JJA agreeing) at pp 548-549; *Guilfoyle 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: *Wesfarmers Bunnings Ltd v Angus & Robertson Bookworld P/L* [1998] VSC 101 at [45] per Gillard J

9. Accordingly to determine whether a preliminary agreement constitutes a binding contractual arrangement there are two principal issues to be addressed[23]: *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"[24].

10. The first issue is whether there has been a "voluntary assumption of a legally enforceable duty" (which is the essence of contract)[25]. For such a duty to arise all the essentials of a contract in the particular case must be set out, including, the parties, the subject matter, and generally, the consideration[26]. 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[27].

11. The second issue - "intention" – will be determined in accordance with the objective theory of contract in the sense that "(i)t describes 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"[28].

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[23] *Masters v Cameron* (1954) 91 CLR 353; 360

[24] *Vroon BV v Foster's Brewing Group Ltd* at 82, citing *Meates v Attorney-General* [1983] NZLR 308 at 377 per Cooke J, and see *Ormwave Pty Ltd v Smith* (2007) 5 DDCR 180 at 195–6 ; [2007] NSWCA 210 at [70]–[76] per Beazley JA cited in *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd* (2007) 20 VR 487; [2007] VSCA 310 per Nettle JA at [6]

[25] *Ermogenous v Greek Orthodox Community of SA Inc* [2002] 209 CLR 95 at [24]; *Maroubra Pty Ltd v Murchison Queen Pty Ltd* [2002] WASC 98 at [59]

[26] 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

[27] ibid, *Masters v Cameron at CLR p. 360;* ibid, *Ermogenous* at [25]

[28] ibid, *Ermogenous* at CLR pp105-6

Masters v Cameron

12. In *Masters v Cameron*[29]*,* the *locus classicus* in relation to preliminary agreements, the High Court identified three categories of preliminary agreements. To these may be added a fourth category identified in Sinclair's case[30] and resurrected by McLelland J in *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd*[31] and now also universally accepted.

13. In *Masters v Cameron,* in a passage which has been influential in Australian jurisprudence, the Court identified three categories of preliminary agreement where the parties who had been negotiating reach agreement upon terms of a contractual nature and also agree that the subject of their negotiation should be dealt with by a formal contract, as follows *(material in parenthesis added)*[32]:

> **(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*)**
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> **(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)***

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[29] *Masters v Cameron* (1954) 91 CLR 353; (1954) 28 ALJR 438 per Dixon CJ, McTiernan and Kitto JJ. 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

[30] *Sinclair Scott & Co Ltd v Naughton* (1929) 43 CLR 310

[31] (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

[32] *Masters v Cameron* (1954) 91 CLR 353 at 360-362

(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 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...
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> Cases of the third class[33] 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.

14. 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"[34]. Again, into which category an agreement will fall will depend on the intention of the parties objectively ascertained[35].

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[33] eg ibid, Factory 5 P/L (in liq) at [104](k) per Foster J

[34] *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

[35] *Masters v Cameron* at 362

15. 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[36]. 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).

The factors for determining whether a preliminary agreement is binding?

16. If the enforceability of a preliminary agreement is at issue, what factors are determinative? It is suggested[37] the main factors in determining whether a preliminary agreement is binding are as follows[38]:

    (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"[39];

    (b) the main factor to consider is the language used by the parties in the agreement for if the intention to enter into a binding agreement is clear and conclusive, the court may not need to look further[40]. If the

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[36] ibid, DW McLauchlan

[37] 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 others noted

[38] These factors will assist practitioners in drawing preliminary agreements so that they will, or will not, be (depending on what their clients wish to achieve) binding contractual documents (and see below para 25, *Lessons for advisers and points to consider when drawing a preliminary agreement*).

[39] *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].

[40] ibid, J Tarrant at p. 164; in *Malago 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 Pty Ltd* (1991) 24 NSWLR 1 at p. 21 "and in negotiating on
fresh or additional terms shall not in the meantime in any way prejudice the full and binding effect of what is now agreed..."; see also *Anaconda Nickel Ltd v Tarmoola Australia P/L* (2000) 22 WAR 101 per Ipp J at 114; and *Fletcher Challenge Energy Ltd v Electricity Corporation of New Zealand* [2002] 2 NZLR 433 referred

language is ambiguous[41], then the other factors referred to in (c)-(e) 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[42] 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 to be supplemented by reasonable implication of necessary terms[43], or by resort to considerations of reasonableness[44] 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)[45], the less willing will be a court to conclude that the parties had the requisite contractual intention;[46]

(e) the magnitude, subject matter or complexities of the transaction may show that the preliminary agreement was not intended to have legal

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to in J Tarrant, ibid, at pp 166-168. 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]).

[41] 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)

[42] Ibid Tarrant at p. 174; *Anaconda* at p. 110

[43] *ABC v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540 at 548 per Gleeson CJ; *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 [122] per Keane CJ

[44] *ABC v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540 at 548 per Gleeson CJ

[45] *Geebung Investments P/L v Varga Group Investments No 8 P/L* (1995) 7 BPR 14,551, 14569-70 per Kirby P; BC9505503; ibid, Tarrant at p. 163 citing inter alia, *Anaconda*, ibid, at 110 per Ipp J

[46] *ABC v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540 at 548 per Gleeson CJ cited by Keane CJ in *Fortescue Metals* at [132]

effect[47] but these factors will give way to the parties' express intention to be bound immediately.[48]

The relevance of conduct and correspondence in the lead up to, and following, the alleged preliminary agreement

17. Evidence of the particular surrounding circumstances[49], including relevant and contemporaneous correspondence[50], whether there has been partial performance of the alleged agreement[51], the subsequent conduct of the parties[52], any prior dealings[53] and any trade practice or custom, and the

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[47] *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 634-5

[48] ibid, *Geebung Investments*, BC9505503 at 38-40; ibid, J Tarrant citing *GR Securities v Baulkham Hills Private Hospital* (ibid) at p. 634 per McHugh J

[49] 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

[50] 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]

[51] 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'

[52] 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-Streeton J; informing the court that a matter had settled rather then settled in principle and abandoning the trial was evidence of an intention to be immediately bound by their agreement: *Grave v Blazevic Holdings P/L* [2012] NSWCA 329 at [60]; ibid, Geebung Investments, BC9505503 at 38-40; ibid, J Tarrant at p. 163; 170-174, referring to, inter alia, *Anaconda Nickel Ltd v Tarmoola Australia P/L* (2000) 22 WAR 101; and see *Cacace v Bayside Operations P/L* [2006] NSWSC 572 at [11] referring to *Brambles Holdings v Bathurst City Council* (2001) 53 NSWLR 153 at [25]; *Gangemi v Osborne & Anor* [2009] VSCA 297 at [24] which material is inadmissible in the interpretation of a written contract. See also *Skilled Group Ltd v CSR Viridian Pty Ltd* [2012] VSC 290 at [97] ff per Vickery J

[53] Ibid, J Tarrant at p. 164 referring to, inter alia, *GR Securities v Baulkham Hills Private Hospital* (ibid).

nature of the relationship between the parties[54] is admissible to determine whether a binding contract was formed.

18. While this evidence is admissible on the question of whether a contract was formed, it is not admissible on the question of what a contract means[55]. 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[56].

19. Accordingly once the court has made its determination on whether there is a binding contract, if it decides that there is one, in deciding what the contract means the court is bound to apply the objective theory of contract. First and foremost this requires that the parties' intentions must be ascertained from the words they have used and the general rule is that extrinsic evidence is not admissible for the purposes of the construction of a written contract[57]. As a digression, despite what was said by three members of the High Court in *Western Export Services Inc v Jireh International Pty Ltd*[58] in refusing special leave to appeal (that the true rule as referred to by Mason J in *Codelfa*[59] that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning), the High Court has recently confirmed that the meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean which will require consideration of the language used by the parties, the surrounding

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[54] *Ermogenous v Greek Orthodox Community of SA Inc* [2002] HCA 8; 209 CLR 95; 76 ALJR 465; 187 ALR 92 at [25]; ibid, J Tarrant at p 164 referring to *Film Bars P/L v Pacific Film Labs* (1979) 1 BPR 9251 per McLelland J; unrep. , NSWSC., 12.11.1979; ibid, *GR Securities Pty Ltd* per McHugh J at 634

[55] *Brambles Holdings Ltd v Bathurst City Council* [2001] NSWCA 61; (2001) 53 NSWLR 153, 163-164 per Heydon JA. This was affirmed by the High Court in *Agricultural and Rural Finance Pty Ltd v Gardiner* [2008] HCA 57; (2008) 238 CLR 570, 582 [35] and followed in Victoria in *Lederberger & Anor v Mediterranean Olives Financial Pty Ltd & Ors* [2012] VSCA 262; (2012) 38 VR 509, [26]-[27] per Nettle and Redlich JJA and Beach AJA

[56] Ibid, *Factory 5 P/L (in liq)* at para [104](k) per Foster J

[57] *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St* [2012] VSCA 134 at [90] referring to Mason J's judgment in *Codelfa* and his citing with approval of Lord Wilberforce in *L Schuler AG v Wickman Machine Tool Sales Ltd*

[58] (2011) 282 ALR 604; (2011) 86 ALJR 1; [2011] HCA 45; BC201108359

[59] *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337 at 352; 41 ALR 367 at 374; [1982] HCA 24

circumstances known to them and the commercial purpose or objects to be secured by the contract. Such purpose or objects is facilitated by an understanding "of the genesis of the transaction, the background, the context [and] the market in which the parties are operating"[60].

Non-contractual remedies

20. In a suitable case an estoppel by conduct may be able to be relied upon precluding denial of the contract's existence[61], or where there is no contract in existence, restitutionary or other remedies may still be available, including for misleading and deceptive conduct, negligent and fraudulent misrepresentation, and in restitution or quasi-contract[62].

Archer Capital Trust 4A v Sage Group plc

21. The case of *Archer Capital Trust 4A v Sage Group plc* is illustrative of how a claim seeking to vindicate rights said to have arisen on the basis of an alleged preliminary agreement may unfold, and the manner in which the respective claims and defences, may be framed. The matter descended into various contested interlocutory stoushes, four of which result in written decisions[63], and may now have resolved[64].

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[60] *Electricity Generation Corp v Woodside Energy Ltd; Woodside Energy Ltd v Electricity Generation Corp* (2014) 251 CLR 640; (2014) 306 ALR 25; (2014) 88 ALJR 447; [2014] HCA 7; BC201401090 at [35]; and see Article, "Recourse to contractual context reaffirmed" by Brent Michael and Derek Wong, (2015) 89(3) ALJ 181-189

[61] *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)

[62] *Pavey & Matthews v Paul* (1987) 162 CLR 221; 256; *Sabemo Pty Ltd v North Sydney Municipal Council* [1977] 2 NSWLR 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. In *Archer Capital 4A Pty Ltd as trustee for the Archer Capital Trust 4A v Sage Group plc* the vendor sued the alleged purchaser for claims which included misleading and deceptive conduct. See "Liability for conduct in pre-contractual negotiations", Lewis and Cooper, n. 7 above

[63] Two of the decisions were reported in the Australian Law Reports and all appear in Austlii: Archer Capital 4A Ltd v Sage Group plc [2012] FCA 1476 (application by respondent for particular/non-standard discovery under rr. 20.13 and 20.15 Federal Court Rules 2011 and by the applicant to set aside subpoenas served by the respondent on Ernst & Young); Archer Capital 4A Pty Ltd (as trustee for Archer Capital Trust 4A) v Sage Group plc (No 1) [2013] FCA 1029; BC201313613 (further application by respondent for discovery under rr. 20.13 and 20.15 of the Federal Court Rules of certain specified categories of documents relating to the tax affairs or liabilities of certain of the Applicants); Archer Capital 4A Pty Ltd (atf) Archer Capital Trust 4A) v Sage Group plc (No 2) (2013) 306 ALR 384; [2013] FCA 1098; BC201313988 (application by the applicants to challenge the privilege claimed by the respondent in respect of 34

22. The Applicants ("Archer Capital") who were shareholders in MYOB Cayman Holdings Ltd which was the holding company of the MYOB group which develops and sells accounting and business management software, commenced proceedings in the Federal Court of Australia in November, 2011 against the UK software giant, Sage Group ("Sage") seeking damages for breach of contract, equitable damages arising from an alleged estoppel and damages for misleading and deceptive conduct. The claim arose out of dealings between the parties for the sale of the shares. Archer Capital alleged that there was a binding contract for the sale of the shares within the first class of case considered in *Masters v Cameron* for a price of $1.35b said to arise from Sage's acceptance on 16 August, 2011 of a written offer. However the offer was stated to be "subject to contract" (which expression was held in *Masters v Cameron* to make it clear that neither of the parties was to be contractually bound until a contract was signed). It was accepted by the parties that a formal contract would need to be drawn that would fully document the terms of the contract and would be entered into and executed in the Cayman Islands. Two days later Sage advised that it would not pay the sum of $1.35b for the MYOB shares. Archer Capital alleged that this amounted to a repudiation of the contract which they accepted. The next day Archer Capital sold the shares to a third party, Bain Capital for $1,045b. in cash together with the assumption of liabilities of $11m. and the provision of vendor notes with a face value upon issue of $150 m. to the First to Ninth Applicants.

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communications to and from Deutsche Bank, from Sage's company secretary and Group legal Director, and documents sent or disclosed by Sage to Deutsch – Held application dismissed except for 2 documents); Archer Capital 4A Pty Ltd (as trustee for Archer Capital Trust 4A) v Sage Group plc (No 3) (2013) 306 ALR 414; [2013] FCA 1160; BC201314433.

[64] According to "Federal Law Search" the status of the case is still open but as nothing has happened in the matter since February, 2014 it may be that the matter has resolved and on 11 February, 2014 Farrell J made orders inter alia, pursuant to s 37AF of the Federal Court of Australia Act 1976 (Cth), that until 4pm on 20 December 2017, certain specified documents (and any duplicates thereof) which include the Bain Bid documents and other bid documents not be disclosed by any person who obtained the document solely as a result of this proceeding (by publication or otherwise) to any person other than a person who is the Australian legal representative of, or an Australian expert witness retained by, the parties. These orders were stated to be necessary to prevent prejudice to the proper administration of justice. Prior to this there were applications by what appeared to be by rival bidders for their bid documents to remain confidential.

23. Archer Capital claimed damages being the difference between the consideration it would have received from Sage and the net value of the consideration received by the Applicants from Bain. The estoppel and misleading and deceptive conduct claims relied on representations said to have been made by the Final Offer ;- in essence that Sage would, subject only to the fulifillment of certain conditions pay to Archer Capital $1,35b for the shares and that the Final Offer was “final, certain and capable of acceptance”. The estoppel case was to the effect that as a result of the representations Archer Capital assumed the existence of a particular legal relationship (that the offer was final, certain and capable of acceptance), that in reliance thereon they acted to their detriment by inter alia, terminating negotiations with other prospective purchasers and that as a result of Sage’s failure to fulifill the assumed legal relationship they suffered loss and damage. By making the representations in the Final Offer Sage engaged in misleading and deceptive conduct. Sage’s defence was that there was no binding contract, and as a result no repudiation or breach that could found a claim for damages. As this was so, its conduct in making the Final Offer could not give rise to any estoppel or actionable misrepresentation.

24. Without the benefit of a final decision and judgment in this matter if there is one lesson to be drawn from this clearly expensive and protracted case it is this: always ensure that the clients’ intentions are made clear.

Lessons for advisers and points to consider when drawing a preliminary agreement

25. With the object of always ensuring that the client’s intentions are made clear, when drawing, or reviewing a preliminary agreement it is suggested practitioners should consider the following ***check-list*** (many, or even all of which, depending on the circumstances will be essential). The ***check-list*** should be read with, and in light of, the *factors for determining whether a preliminary agreement is binding* (referred to in paragraph 16 above):

(a) the proper identification of the parties;
(b) a statement of the transaction contemplated;
(c) a description of the products or services proposed to be sold or purchased (that is, adequate identification of the subject matter);
(d) the consideration, or a formula for determining it;
(e) whether there are conditions precedent or subsequent to the agreement;
(f) all the critical agreed terms (but no more than this)[65];
(g) a time-frame for completion;
(h) the parties' intentions to be bound or otherwise are properly set out; and
(i) whether there are any statements or representations which might create an expectation or encourage reliance[66].

Conclusion

26. In commerce parties will have a variety of different agendas in entering into preliminary agreements. The parties may have the best of intentions when agreements are signed, but subsequent events may get in the way, and the greatest benefit of such agreements of flexibility and brevity, may end up being their flaw. Each party may wish to have the other bound but be free to renegotiate or withdraw; or one or other party may wish to be purposefully ambivalent. 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,

[65] 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 LIJ 52
[66] adapted from ibid, R Macey

as well as the very benefits which such agreements offer, have commonly led to disputes and litigation.

27. It is critical in drawing or settling a preliminary agreement that the client's intentions are achieved. From a lawyer's perspective 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.

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