Shaking Hands With the Devil: New Rules for Letters of Intent and Oral Contracts

FM Panelists: Craig R. Carter, Andrew S. Nunes
Guest Panelist: Peter E. Brent, Corporate Secretary, Nordion Inc.

Toronto Fasken Martineau Symposium
Wednesday, April 27, 2011

Roadmap

I. Introduction
II. Agreeing on Fundamental Terms - the old law
III. Consensus Ad Idem - the Gretzky case
IV. Letters of Intent and Contracts by Conduct - the Wallace and Allen case
V. Oral Contracts, the Statute of Frauds and Part Performance - the Erie Sand and Gravel case
VI. Practice Tips for Avoiding Unwanted Contractual Relationships
I. INTRODUCTION

- When is a binding contract created?
- Recent case law may suggest a shift further away from certainty in contractual formation
- Written intentions may not have the intended effect
- Seemingly innocuous conduct could lead to unexpected contractual obligations
- The rules for the enforcement of oral real estate contracts have changed
- How do we protect our clients?
I. Introduction

Back to School – Contracts 101

- A legally binding contract requires (among other things):
  - certainty of (essential) terms
  - intention to create legally binding obligations
  - consensus ad idem

II. AGREEING ON FUNDAMENTAL TERMS
- the old law
II. Agreeing on Fundamental Terms – the old law

- “agreements to agree” or “agreements to negotiate” are not enforceable
- courts will not supply essential or fundamental details for the parties that have not been agreed to
  - *Kelly v. Watson* (1921, SCC)
- lack of agreement on all terms will not necessarily be fatal
  - *Calvan Consolidated Oil & Gas Company Limited v. Manning* (1959, SCC)
- courts may enforce agreements that fail to speak to minor details

- missing terms may be determined by the court based on relevant law
  - e.g. sale of goods – *Calvan Consolidated Oil & Gas Company Limited v. Manning* (1959, SCC); *Kay Corporation et al. v. Dekeyser et al.* (1977, Ont. CA) – missing payment terms
  - e.g. commercial leases – *Canada Square Corporation Ltd. et al. v. VS Services Ltd. et al.* (1981, Ont. CA) – missing a specific description of the premises, date of lease commencement and date of rent payments
II. Agreeing on Fundamental Terms – the old law – the old law

- missing terms may otherwise be determined by the court. In Hillas the court stated:
  “It is clear that the parties both intended to make a contract and thought they had done so. Business men often record the most important agreements in crude and summary fashion; … It is accordingly the duty of the Court to construe such documents fairly and broadly, without being too astute or subtle in finding defects … but on the contrary, this does not mean that the court is to make a contract for the parties or go outside the words they have used, except in so far as there are appropriate implications of law, as for instance, the implication of what is just and reasonable to be ascertained by the court as matter of machinery where the contractual intention is clear but the contract is silent on some detail.”

II. Agreeing on Fundamental Terms – the old law – the old law

- how do you determine which terms are essential?
- parties? price? description of product/service? others?
- driven by the particular facts – no set formula
- consider nature of the agreement, nature of the missing term, its relationship to the whole bargain, conduct of the parties
- minor detail or TBD?
  - “Where terms other than price are left open, there is again no rule of thumb. Where fundamental aspects of an agreement appear to the court to be missing, enforcement will be refused … perhaps the most useful test is as was stated in a recent Canadian case, whether a further “meeting of minds” is anticipated.” (Waddams)
III. CONSENSUS AD IDEM –  
the GRETZKY CASE

- Wayne and Janet Gretzky looking to purchase a cottage in Muskoka
- parties agreed on essential terms such as price, closing, lands, etc.
- no agreement on when the different items in the boathouse had to be cleared out – negotiated back and forth
- response to latest proposal from Gretzkys - “I think we can work with that proposal” – ad idem?
- court held that no contract because no meeting of the minds on essential terms - the parties, property and purchase price are not necessarily the only essential terms of a contract – as far as the parties were concerned, the term with respect to possession of the boathouse was also essential
- subjective test: what did the parties consider essential? To what extent were the terms negotiated?
IV. LETTERS OF INTENT and CONTRACTS BY CONDUCT

IV. Letters of Intent and Contracts by Conduct

• Letter of Intent (LOI)
  • definition
  • utility
  • purpose
• whether a LOI forms a binding contract depends on
  • the wording used
  • all the circumstances, including the conduct of the parties
IV. Letters of Intent and Contracts by Conduct

United Trust Co. v. Dominion Stores Ltd. (1977, SCC)

• General Rule: Where the offer or acceptance is expressed to be “subject to contract”, “subject to terms of a lease”, “subject to a lease to be drawn up by our clients’ solicitors”, “subject to the terms of a formal agreement to be prepared by their solicitors”, the agreement will be construed, in the absence of circumstances showing a contrary intention, to be conditional and still subject to negotiation until actual execution of the more formal document by the parties.

In this case the court found there to be a contract, even though it was subject to approval of the landlord’s solicitors.

• not expressly stated to be “subject to lease”
• solicitor approval was just for accuracy
• distinction between “whether the parties intended that the terms agreed on should merely be put into form, or whether they should be subject to a new agreement the terms of which are not expressed in detail”.

• See also Hatzfeldt-Wildenburg v. Alexander (1912, U.K.) and Winn v. Bull (1877, U.K.). See also Calvan Consolidated Oil & Gas Co. v. Manning (1959, SCC) – Court found that the parties were bound immediately on the execution of the informal agreement; all that remained to be done was to embody the precise terms of the information agreement into a formal agreement.
IV. Letters of Intent and Contracts by Conduct

Canada Square Corporation et al. v. VS Services Ltd. et al.
(1981, Ont. CA)
- court found there to be a binding agreement even though the condition as to approval by the landlord’s lender was never satisfied and the preliminary agreement contained language that suggested further negotiation was required (as well as lack of certainty of some required terms for a lease)
- no clear reference to the need for any further documentation in the form of an agreement or lease
- represented by sophisticated businessmen who had authority to bind
- parties acted as though they were contractually bound
- conduct of the parties subsequent to the purported making of a contract must be considered in determining whether the parties made a binding contract

IV. Letters of Intent and Contracts by Conduct – the Wallace and Allen Case

Wallace vs. Allen (2009, Ont. CA)
- varying the judgment of the Ontario Superior Court of Justice
- conduct of the parties subsequent to the purported making of a contract considered in determining whether the parties made a binding contract, notwithstanding a reference to the need for a further written agreement
IV. Letters of Intent and Contracts by Conduct– the Wallace and Allen Case

FACTS

• Wallace looking to purchase business in Orillia from neighbour and friend, Allen
• September 24, 2004, parties sign a LOI prepared by Wallace, which provided that “there will be much legal work to be done upon acceptance by both sides and that wording of this agreement may alter somewhat”. It was to be “reduced into a binding agreement of purchase and sale by the parties within 40 days” – inserted by Wallace
• The next working day until December 22, 2004, Wallace was at Allen’s side meeting the employees, customers and professional contacts necessary to the business operations; allowed for due diligence and learning the business
• Allen and Wallace continued to work through some tax-related issues and other issues

FACTS (cont.)

• Wallace’s son left job, moved to Orillia, started working at new business
• Parties met with their lawyers on December 9, 2004, and agreed on most points, although new terms were subsequently introduced
• Allen and Wallace together met with the bankers and insurance agents to arrange for a transition of mortgage security and insurance coverage
• December 22, 2004, final draft of Share Purchase Agreement exchanged between lawyers that they could both recommend to their clients
IV. Letters of Intent and Contracts by Conduct– the Wallace and Allen Case

FACTS (cont.)

• December 29, 2004, Allen in lawyer’s office ready to close; Wallace in Florida at Allen’s insistence; Allen decides to walk due to some concerns re property tax arrears and potential liability under a contract that surfaced at the 11th hour, which turned out to be immaterial (although Allen’s lawyer made a big deal about it)
• Wallace rushed back from Florida, solved the troublesome issues and wanted to close but Allen refused
• Went from best friends to enemies overnight

FINDINGS

• LOI is a binding contract; Wallace and Allen intended to be bound by it
• evidenced by the language in the LOI
  • “it is agreed”, “upon acceptance”, “the wording of this agreement may also vary somewhat”
  • “this letter of intent must be reduced to a binding agreement”
• evidenced by the conduct of the parties prior to and after signing the LOI
  • Allen had refused to sign the previous versions of the LOI because too much was outstanding
  • Allen told employees that he had sold the business to Wallace and introduced Wallace as the new owner
  • Wallace bought a house for his son in Orillia close to the business and asked his son to quit his secure job to come and work in the business
  • Allen showed up at the closing fully prepared to close the deal based upon the SPA finalized by the lawyers
IV. Letters of Intent and Contracts by Conduct– the Wallace and Allen Case

QUESTIONS
1. Did the Court make the right decision?
2. Is this a change or shift in the law, or just an unusual application of the current law to a unique fact scenario?
3. Was this really about a binding LOI, or was the court trying to find a way to achieve the “correct” result in terms of fairness?
4. Is it fair that Wallace was successful in a finding that the LOI was binding even though he inserted the clause that was intended to ensure that it was not binding?
5. To what extent are the lawyers to blame?

V. ORAL CONTRACTS, THE STATUTE OF FRAUDS AND PART PERFORMANCE – THE ERIE SAND AND GRAVEL CASE
Enforceability of Oral Contracts

**RULE 1**

**ORAL CONTRACTS FOR REAL ESTATE ARE NOT ENFORCEABLE**

Statute of Frauds, R.S.O. 1990 C.S.19
Section 4
4. No action shall be brought...upon any contract or sale of lands, tenements or hereditaments or any interest in or concerning them, unless the agreement upon which the action is brought, or some memorandum or note thereof is in writing and signed by the party charged therewith or some person thereunto lawfully authorized by the party.

Enforceability of Oral Contracts – Cont’d

- This applies to court actions only
- Contract or sale of lands
- Contract or sale of any interest in or concerning lands
- Unless agreement is in writing
- Unless memorandum or note in writing signed by the other party
Purpose of Statute of Frauds

• Statute was passed to prevent fraud and forgery in court proceedings

• Why are real estate actions more prone to fraud and forgery then business contracts

• No justification why oral contracts for real estate should not be enforceable

Part Performance

RULE 2
SOME ORAL CONTRACTS FOR REAL ESTATE ARE ENFORCEABLE

• Memorandum in writing signed by one party

• Part performance
Rule 3: An enforceable oral real estate contract becomes enforceable if there is part performance

- If one party has fulfilled its side of a real estate oral contract then court will enforce the oral contract on other side
- Court created exception to statute of frauds which reverses statute in limited circumstances
- Part performance rule prevents fraud

OLD LAW:


FACTS: Aunt agrees to give nephew one of her two houses upon her death so long as he is good to her and does such services as she may request.

Nephew did chores while staying at house and took aunt on a trip to Montreal.

Decision: No part performance therefore contract not enforceable
Part Performance – Cont’d

DEGLEMAN RULES

Step 1:
  • PARTY ALLEGES ORAL CONTRACT

Step 2:
  • PARTY ALLEGES EXAMPLES OF PART PERFORMANCE

  • EXAMPLES OF PART PERFORMANCE
    • Pays Deposit
    • Does Inspections
    • Enters Into Lease
    • Does Renovations
    • Pays Purchase Price
    • Takes Possession
    • Takes Vendor on holiday
    • Submits offer
    • Gives Vendor a bottle of scotch
    • Drives aunt to Montreal
Part Performance – Cont’d

Step 3:
• PARTY MUST SHOW ITS PART PERFORMANCE IS A DETRIMENT TO IT
  • Spent money
  • Gave up other rights
  • But –
    • Never payment of deposit
    • Never loss of land

Part Performance – Cont’d

Step 4:
• DEGLEMAN TEST (4-3 split decision on test)
  • TEST:
    • Minority stringent test
    • Majority easier test
  • Majority Decision: Part Performance must be
    • “unequivocally and in their own nature referable to some such agreement as that alleged i.e., to an agreement respecting the lands themselves”
    • “referable in their own nature to some dealing with the land”
Part Performance – Cont’d

Step 5:

- NOW YOU CAN PROVE ORAL CONTRACT USING ALL VARIOUS TOOLS OF INTERPRETATION
  1. Intention of parties
  2. Implied terms
  3. Conduct
  4. Available writings
  5. Oral evidence

THE NEW LAW


FACTS:

- Seres owns lands subject to right of first refusal (ROFER) in favour of Tri-B
- Erie Sand meets Seres and they orally agree that Seres will sell to Erie Sand subject to ROFER
- Seres says give me an offer I can take to Tri-B on agreed terms
- Seres says if Tri-B doesn’t buy I will sell to you
- Erie Sands prepares offer – adds deposit equal to full purchase price
- Seres does not sign offer
- Seres takes unsigned offer to Tri-B
- Seres agrees to sell to Tri-B on the terms of the Erie Sands offer but changes closing date and the amount of deposit
- Erie sues Seres and Tri-B for specific performance of oral agreement to sell to Erie because Tri-B agreement not identical
New Law

Step 1 – Prove oral contract

Step 2 – Alleging party performance by either party

Step 3 – Show detriment
  • losing property is a detriment
  • acts of either party

Step 4 – Acts of part performance referable to this land
  • Since contract proven already not an issue

Old Law

Step 1 – Alleging oral contract

Step 2 – Alleging party performance by party alleging contract

Step 3 – Show detriment using acts of person alleging contract
  • losing property never a detriment
  • Acts of alleging party only

Step 4 – Acts of part performance referable to this land

Step 5 - Prove oral contract using part performance of all parties as a tool

Result

• Oral real estate contracts more likely enforceable: not much left
• Post contract conduct constitutes past performance
• Dangerous because delivery of offer may be part performance of pre-existing oral contract
• How do we protect ourselves
VI. PRACTICE TIPS FOR AVOIDING UNWANTED CONTRACTUAL RELATIONSHIPS

1. LOI itself should clearly evidence the parties’ intention not to be bound
   • do not use words or phrases such as “I agree” or “this Agreement” or
     “the parties agree to the following”
   • specifically provide that the LOI (or a certain portion of the LOI) is not
     binding on the parties and does not create a contract between the
     parties
   • specifically provide that the parties are only to be bound when a formal
     contract embodying the terms of the LOI and such other matters as the
     parties consider appropriate is settled and signed by the parties
   • provide it is a condition of the parties’ obligation to complete the
     transaction that a formal agreement of purchase and sale has been
     signed by the parties
   • insert other conditions precedent or closing conditions
   • make it clear that further negotiation is required and that there are other
     essential terms
   • provide that this intention not to be bound continues notwithstanding
     any subsequent negotiation and settling of all or part of the issues to be
     resolved and notwithstanding all issues have been settled between the
     parties
VI. Practice Tips for Avoiding Unwanted Contractual Relationships

2. Manage the post LOI conduct to avoid a finding that the parties by their conduct have amended the terms of the LOI to make it binding or to have entered into a contract by conduct not withstanding language in the LOI stipulating the contrary
   - properly drafted correspondence between the parties and the lawyers submitting drafts – all issues are open until all issues are settled; no agreement will be binding until agreement is executed
   - communications to employees, press releases, letters to suppliers etc. should be carefully managed
   - careful approach to “learning the business” and preparations in anticipation of closing – how far do you go, which steps should you not take?
   - reiterate that no deal until a sign (and close)
   - how do you conduct yourself at the closing?

QUESTIONS and COMMENTS

This presentation contains statements of general principles and not legal opinions and should not be acted upon without first consulting a lawyer who will provide analysis and advice on a specific matter.
Fasken Martineau DuMoulin LLP is a limited liability partnership under the laws of Ontario and includes law corporations.