When Negotiations Become Binding: The "I" In "LOI"



It is not uncommon for parties in a commercial transaction to get involved in lengthy, complicated negotiations with numerous draft agreements going back and forth. They may even come to terms on many, if not all, of the substantive aspects of the deal. What happens if negotiations break down or terminate before a formal agreement is signed? In the recent decision of *Hartslief v Terra Nova Royalty Corporation*, the British Columbia Court of Appeal confirmed that the execution of a formal written agreement is not always necessary for parties to be bound.[1] In addition, the court confirmed that, absent a clear understanding to the contrary, solicitors negotiating on behalf of their clients can bind their clients to an agreement.

Although the *Hartslief* case arises in the context of a termination of employment, its relevance in any commercial negotiations illustrates the merits of clearly setting out the parties' intentions at the outset of negotiations, in a letter of intent ("**LOI**"), term sheet or other similar document, to avoid unintended consequences.

What Happened

The facts of the case are fairly straightforward. Alan Hartslief (the "**Plaintiff**") brought an action against his former employer, Terra Nova Royalty Corporation (the "**Defendant**"), seeking a declaration that a binding settlement agreement had been reached by the parties following extensive negotiations between their respective solicitors. The Defendant disputed the existence of a binding agreement and argued that it was the parties' joint intention that a binding settlement would only arise upon the signing of a formal document. The Defendant also claimed that its solicitors did not have authority to bind it to an agreement.

The Decision

On the question of a lawyer's ability to bind his or her client, the court reaffirmed that the law is clear and well-understood: "unless a solicitor clearly communicates the contrary to those with whom he or she is negotiating, a solicitor is the agent of his or her client and thus may bind the client to an agreement … [a]fter all, a solicitor "acts for" the client."[2] Furthermore, there is no obligation on the parties to make enquiries regarding a solicitor's authority to bind a client, and the mere fact that a solicitor seeks instructions from a client is not enough to rebut this

presumption.

With respect to the question of when negotiations lead to a binding agreement, the court relied on the general principles set out by the Ontario Court of Appeal in *Bawitko Investments Ltd. v Kernels Popcorn Ltd.* [*Kernels*]:

"When [the parties] agree on all of the essential provisions to be incorporated in a formal document with the intention that their agreement shall thereupon become binding, they will have fulfilled all the requisites for the formation of a contract. The fact that a formal written document to the same effect is to be thereafter prepared and signed does not alter the binding validity of the original contract.

However, when … the understanding or intention of the parties, even if there is no uncertainty as to the terms of their agreement, is that their legal obligations are to be deferred until a formal contract has been approved and executed, the original or preliminary agreement cannot constitute an enforceable contract…. The execution of the contemplated formal document is not intended only as a solemn record or memorial of an already complete and binding contract but is essential to the formation of the contract itself …"[3]

In negotiating an agreement (either directly or through legal counsel), if a party does not wish to be bound prior to the execution of a formal agreement, then it should make its intentions known expressly. Otherwise, a court will infer the parties' intentions by considering the conduct of the parties and all other surrounding circumstances. In *Hartslief*, the court found on the totality of the evidence, viewed objectively, that an agreement had been reached and that the signing of a formal agreement was not intended by the parties to be a condition precedent.

Letters Of Intent

The issues addressed in this case are relevant to any commercial negotiations. Complex, sometimes protracted, negotiations can stretch over weeks or months, and, as the court in *Hartslief* stated, binding agreements may be expressed orally or by way of memorandum, by exchange of correspondence, other informal writings, or any conduct that explicitly or implicitly signifies to the outside world an intention to be bound.[4] In such circumstances, it is important for parties to be clear about their intentions.

Having in place a properly drafted LOI allows the parties to negotiate freely without uncertainty as to when binding obligations will arise. It is essential, however, for the parties to include in the LOI a clear and express provision that they will not be bound until a formal, written document is negotiated and signed, if that is their intention. Absent such a provision, courts will take an objective approach (considering both the LOI terms and the intentions of the parties as evidenced by all surrounding circumstances) in determining whether or not an agreement has been reached. The LOI also affords parties the opportunity to set out the key terms of the deal to be reflected in a formal document and to expressly agree on any matters that will be binding on them prior to signing a formal agreement, such as the payment of transaction expenses or break fees, and any confidentiality or exclusivity covenants.

At The End Of The Day, Make Your Intentions Clear

The *Hartslief* case illustrates the importance of clearly expressing and documenting at the outset of commercial negotiations the intentions of the parties as to when binding obligations will arise. Failure to make such intentions clear, and not deviate from those intentions in the course of negotiations, could lead to being bound even in the absence of a formal written agreement.

Footnotes

1 *Hartslief v Terra Nova Royalty Corporation*, 2013 BCCA 417.

2 *Ibid* at para 22.

3 (1991) 79 DLR (4th) 97 (CA) at 103-104.

4 *Ibid* at paras 9-10.

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