LexisNexis Conference

Contract Law Intensive
Part 1 – Fundamental concepts

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1. Introduction

I have kindly been invited to discuss with you today some of the fundamental concepts of contract law.

We will first discuss contract formation in the broad sense by briefly outlining some of the basic tenets, digressing along the way to consider contract formation in some new and interesting contexts.

Then we will build on that foundation by discussing in more detail the following challenges:

- contracts resulting from conduct;
- *Masters v Cameron* and letters of intent; and
- contract interpretation, ambiguity and extrinsic evidence.

We will conclude by drawing together some of the themes that emerge.

2. Contract Formation

Of course a contract is generally formed when there has been:

- an offer and an acceptance;
- consideration flowing from the offeree;
- the intention to create legal relations; and
- sufficient certainty of terms.

2.1 Offer and Acceptance

Classically, we commence our analysis by identifying a discrete offer and then searching for a matching acceptance, which together evidence an agreement having been concluded.

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However, we have all experienced the practical difficulty of discerning these two discrete contractual components from the imperfect composite of documents and instructions typically provided by our clients. Then there are the particularly difficult transactions, like those involving vending machines or tickets for travel or the like, for example.

Increasingly courts have shown a preparedness to infer the conclusion of an agreement from the parties' conduct without necessarily slavishly adhering to the classical analysis,[2] and we will consider this in more detail later.

For present purposes however, we will adopt the traditional approach and confine ourselves to more straightforward transactions, before considering some recent developments.

Offer

The important characteristics of an offer include the following:

- An offer must be distinguishable from an invitation to treat. Whereas an offer will be expressed in promissory terms so as to give rise to a binding agreement if accepted, an invitation to treat is an invitation designed to induce potential offerors to come forward and do so.[3]

- An offer may be made to a particular person or legal entity … or to the whole world as in the Carbolic Smoke Ball case.[4]

- An offer must have been communicated to the offeree such that the offeree has actual knowledge of the offer and is motivated by it.[5]

- An offer may lapse or be withdrawn before it has been accepted.[6]

Acceptance

It is the acceptance of an offer that concludes the agreement which becomes the contract.

The important characteristics of an acceptance include the following:

- An acceptance must generally be communicated to the offeror, although there are exceptions to this, for example:

  - » A unilateral contract may be accepted by the performance by the offeree of the act contemplated by the offer.[7]

  - » Where the postal rule applies, acceptance occurs when the communication has been sent.[8] This only applies to non-

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[2] *Brambles Holdings Ltd v Bathurst City Council* (2001) 53 NSWLR 153.

[3] See *Fisher v Bell* [1960] 3 All ER 731 regarding shop window displays and *Pharmaceutical Society of Great Britain v Boots Chemist* [1953] 1 All ER 482 regarding supermarket displays.

[4] *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256.

[5] *R v Clarke* (1927) 40 CLR 227, although it should be noted it is rare that there will be evidence of motivation and it is regularly inferred.

[6] *Ballas v Theophilos (No 2)* (1957) 98 CLR 193 and *Payne v Cave* [1775- 1802] All R Rep 492.

[7] *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256.

instantaneous forms of communications.[9] Where communication is instantaneous, for example telephone conversations or facsimile transmissions, acceptance occurs when the message is received.[10]

- An acceptance must be unconditional, otherwise it will be a counter-offer operating to reject the original offer.[11]

- An acceptance must be within the time stipulated, or within a reasonable time if no time is stipulated.[12]

e-Commerce

The advance of technology in recent decades, particularly with respect to electronic communication, has radically changed the way business is transacted. For example, the preponderance of email and commercial websites is rapidly rendering both postal services and the postal rule largely redundant.

However, the great strength of the common law has always been its capacity to evolve incrementally to deal with such challenges and it is again having to prove itself adept to regulate contemporary transactions, particularly with respect to invitations to treat and acceptance.

As discussed, the position is generally that the display of goods for sale is an invitation to treat designed to induce customers to make an offer which can then be accepted or rejected by the vendor.[13] However, with e-commerce, it may not always be easy to distinguish between an invitation to treat and an offer.

Indeed, you may recall that only a month or so ago, it was widely reported that the retailer JB Hi-Fi listed on its website a particular model of high-definition television, which usually sells for $3,500, at a price of only $15.00.

According to *The Age* newspaper, some 105 people ordered televisions, one person 65, with some claiming to have received some form of receipt by email.

The retailer claimed that the price was a mistake and that it had intended that the usual price should have been reduced by 15%, not reduced to $15.00. It declined to fill the orders but offered to supply the televisions at 15% less than the usual price and with a further discount of almost $500.

It is not clear from what is known publicly whether the orders placed through the website are properly characterised as offers induced by an invitation to treat or acceptances of an offer. It would be relevant to know any terms and conditions that may have been incorporated in the transaction and the precise nature of any acknowledgment by the retailer. Of course, if

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[8] *Adams v Lindsell* (1818) 1 B & A1d 681.

[9] *Entores Ltd v Miles Far East Corporation* [1955] 2 All ER 493.

[10] *Brinkibon Ltd v Stahag Stal und Stahlwarenhandelsgesellschaft mbH* [1982] 1 All ER 293.

[11] *Hyde v Wrench* (1840) 3 Beav 34; 49 ER 132.

[12] *Ballas v Theophilus (No 2)* (1957) 98 CLR 193.

[13] *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern)* [1953] 1 All ER 482.

a contract was formed, it may have been vitiated by a mistake which was known, or which ought to have been known, to the offerees.

Something strikingly similar occurred in the United Kingdom in 1999 where a retailer named Argos listed on its website televisions for £2.99 each rather than £299.00. Many televisions were ordered before the error was rectified, and as with JB Hi-Fi, one savvy person ordered 1,700 televisions sets. It is not publicly known how the situation was resolved but it is understood that Argos argued that either its website was an invitation to treat such that no contracts were formed or there was a mistake vitiating any contracts.

In 2004, the Singapore High Court dealt with an internet mistake in *Chwee Kin Keong v Digilandmall.com Pte Ltd*.[14] The facts are similar to those above. Six friends placed orders over the internet for 1606 Hewlett Packard commercial laser printers for S$66 each. The printers usually retailed for S$3854.

By outlaying S$105,996, the six plaintiffs sought to buy laser printers with a retail value of S$6.1 million. There were 778 other people who had also ordered printers so that a total of 4086 printers had been ordered.

The defendants, upon learning of their mistake, removed the printer from their website and informed anyone who had ordered that the orders would not be filled.

The defendants argued that there had been no concluded contract, alternatively there had been a mistake which vitiated any contract.

At first instance, Rajah JC held that although there was a contract, it was vitiated by the doctrine of unilateral mistake.

With respect to formation, his Honour said:

> *"91 There is no real conundrum as to whether contractual principles apply to Internet contracts. Basic principles of contract law continue to prevail in contracts made on the Internet. However, not all principles will or can apply in the same manner that they apply to traditional paper-based and oral contracts. It is important not to force into a Procrustean bed principles that have to be modified or discarded when considering novel aspects of the Internet.*
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> *…*
>
> *101 The applicable rules in relation to transactions over the worldwide web appear to be clearer and less controversial. Transactions over websites are almost invariably instantaneous and/or interactive. The sender will usually receive a prompt response. The recipient rule appears to be the logical default rule. Application of such a rule may however result in contracts being formed outside the jurisdiction if not properly drafted. Web merchants ought to ensure that they either contract out of the receipt rule or expressly insert salient terms within the contract to deal with issues such as a choice of law, jurisdiction and other essential terms relating to the passing of risk and payment. Failure to do so could also result in calamitous repercussions. Merchants may find their contracts formed in foreign jurisdictions and therefore subject to foreign laws."*

The Court of Appeal found the issue of formation to be relatively straightforward:[15]

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[14] [2004] SGHC; affirmed in *Chwee Kin Keong and Others v Digilandmall.com Pte Ltd* [2005] SGCA 2.

[15] *Chwee Kin Keong and Others v Digilandmall.com Pte Ltd* [2005] SGCA 2.

> *"29 It is common ground that the principles governing the formation of written or oral contracts apply also to contracts concluded through the Internet. In the present case, it is not in dispute that prima facie a contract was concluded each time an order placed by each of the appellants was followed by the recording of the transaction as a "successful transaction" by the automated system. The system would also send a confirmation e-mail to the person who placed the order within a few minutes of recording a "successful transaction"."*

The position may have been different had the defendants incorporated terms and conditions and a confirmatory email reserving their rights, including in respect of pricing mistakes.

It should also be noted that a relatively uniform *Electronic Transactions Act* exists at both federal and state levels to regulate some of these issues.[16]

2.2 Consideration

Leaving both promises under deed and estoppel[17] to one side, it is consideration that makes a promise enforceable as a contract.

In order to enforce a promise as a contract, the promisee must have done something or promised to do something in exchange.[18] This is the promisee's consideration for the promise.

Briefly, the rules of consideration include that:

- consideration must flow from the promisee;[19]
- there must be a relationship of *quid pro quo* between the offer and the consideration;[20]
- consideration need not be commercially adequate[21] but it must be legally sufficient;[22]
- past consideration is no consideration;[23]
- the compromise of a claim or a forbearance to sue may be good consideration;
- the performance of parallel public or contractual duties will not be good consideration unless exceeded; and

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[16] For a commentary, see A Lawrence, *The law of ecommerce* (loose-leaf service, LexisNexis).

[17] *Walton Stores (Interstate Ltd) v Maher* (1988) 164 CLR 387.

[18] *Australian Woollen Mills Pty Ltd v Commonwealth* (1954) 92 CLR 424.

[19] *Coulls v Bagot's Executor & Trustee Co Ltd* (1967) 119 CLR 460.

[20] *Australian Woollen Mills Pty Ltd v Commonwealth* (1954) 92 CLR 424.

[21] *Chappell & Co Ltd v Nestle Co Ltd* [1960] AC 87; [1959] 2 All ER 701.

[22] *Placer Development Ltd v Commonwealth* (1969) 121 CLR 353.

[23] *Anderson v Glass* (1865) 5 WW & A'B (L) 152.

- the payment by a debtor of a lesser sum will not be sufficient consideration to bind a creditor to a promise to forgo the balance.[24]

2.3 Intention

The High Court in *Australian Woollen Mills Pty Ltd v Commonwealth*[25] noted that:

> *"It is of the essence of contract, regarded as a class of obligations, that there is a voluntary assumption of a legally enforceable duty."*

Where the exchange of an offer and an acceptance has concluded an agreement between commercial parties for which there is consideration, a binding contract will usually arise because it will be inferred from such conduct by the parties that they intended to create legal relations.[26]

The test for establishing the requisite intention is:

> *"not with the real intentions of the parties, but with the outward manifestations of those intentions."*[27]

Additionally, the High Court said in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd:*[28]

> *"This court, in Pacific Carriers Ltd v BNP Paribas, has recently reaffirmed the principle of objectivity by which the rights and liabilities of the parties to a contract are determined. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe."*

The result is that it is often not in doubt that commercial parties intended to create legal relations.

Equally, if those parties make it sufficiently clear that they do not intend to create legal relations, this will be respected by the courts.[29]

Other agreements recognised as not giving rise to legal relations include domestic and social agreements, as well as agreements with governments implementing policies.

Where the real difficulties arise is with respect to such ambiguous arrangements as:

- partnering agreements;
- alliance contracts;

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[24] *Pinnel's* case (1602) 5 Co Rep 117a; 77 ER 237; [1558-1774] All ER Rep 612.

[25] (1954) 92 CLR 424 at 457.

[26] Edwards v Skyways Ltd [1964] 1 ALR 494.

[27] *Taylor v Johnson* (1983) 151 CLR 422 at 428.

[28] (2004) 219 CLR 165 at [40].

[29] *Jones v Vernon's Pools Ltd* [1938] 2 All ER 626.

- letters of comfort;
- letters of intent;
- memoranda of understanding;
- heads of agreement; and
- conditional agreements.

2.4 Certainty

The general rule is that, provided a contract is sufficiently clear and complete that it is capable of a meaning, then the court will uphold the contract and "*decide its application*" without a "*narrow or pedantic approach*",[30] even where that is difficult,[31] particularly if the parties have commenced to perform it.[32]

This can be achieved by:

- interpreting the contract to give effect to the parties' apparent intentions;[33]
- implying a missing essential term by reference to what is reasonable in the circumstances and consistently with what is usual for similar transactions;[34] and
- resolving errors and ambiguities.[35]

However, the court will be reluctant to decide a term where:

- it is without guidance by reference to a usual standard;[36] and
- the parties have deferred agreement as to an essential term.[37]

2.5 Contract Formation Case Study

In *Mildura Office Equipment & Supplies Pty Ltd v Canon Finance Australia Ltd,*[38] the Victorian Supreme Court revisited the fundamental tenets of contract formation.

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[30] *Upper Hunter County District Council v Australian Chilling & Freezing Co Ltd* (1968) 118 CLR 429 per Barwick CJ at 436-7.

[31] *Meehan v Jones* (1982) 149 CLR 571.

[32] Turner v Bladin (1951) 82 CLR 463 at 471.

[33] *Fitzgerald v Masters* (1956) 95 CLR 420.

[34] *Upper Hunter County District Council v Australian Chilling & Freezing Co Ltd* (1968) 118 CLR 429 per Barwick CJ at 436-7.

[35] *York Air Conditioning v Commonwealth* (1949) 80 CLR 11 at 62 per Dixon J.

[36] *York Air Conditioning v Commonwealth* (1949) 80 CLR 11 at 62 per Dixon J.

[37] *Thorby v Goldberg* (1964) 112 597.

[38] [2006] VSC 42; affirmed on appeal [2007] VSCA 112.

Dodds-Streeton J summarised the proceeding as follows:

> *"[1] In this proceeding, the plaintiff, Mildura Office Equipment & Supplies Pty Ltd, claims that the defendant, Canon Finance Australia ("CFA"), breached an agreement made between the parties in early 1998.*
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> *[2] The plaintiff claims that the defendant's representatives, in the course of a five minute comic skit at a Canon Australia business dealers' conference in February 1998, made a contractual offer to sell all Canon photocopiers…for only $1 when the rental agreements expired or terminated (irrespective of whether its dealership was by that stage still on foot), in consideration for the dealer procuring its customers to enter rental agreements with the defendant. The plaintiff maintains that it accepted the defendant's contractual offer by procuring a customer to enter a rental agreement with the defendant in April 1998, thereby concluding a "unilateral" contract of the Carlill v Carbolic Smoke Co Ltd (" Carlill v Carbolic") class. It argues that the parties subsequently agreed to successive additional terms of the contract, which expanded the types and brands of machines available for the $1 purchase. Throughout the plaintiff's Canon Australia business dealership, it purchased various photocopiers and office equipment from the defendant for $1 at the end of their rental agreements. After the plaintiff's Canon Australia business dealership was terminated in February 2003, the defendant refused to sell the plaintiff photocopiers or other equipment for $1 at the end of the rental agreements. The plaintiff claims that the defendant has thereby breached the contract.*
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> *[3] The defendant does not deny that, as an incentive to increase its financial services business, its officers represented, during the skit at the conference, that dealers would be entitled to purchase for $1 certain photocopiers at the expiration of rental agreements in their dealer's area…*
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> *[4] It contends, however, that the representations made during the skit were too vague and uncertain to amount to a contractual offer and that no act of performance was specified as consideration. Moreover, the subsequent conduct of the parties did not evidence or establish a contractual relationship. Rather, the defendant argues that the statements made during the skit related to an incentive scheme or campaign and did not give rise to legally enforceable entitlements. …"*

Her Honour summarised the parties' contentions as follows:

> *"[109] In essence, the plaintiff contends that the announcement made at the conference constituted a clear, unambiguous offer which outlined the essential terms with sufficient certainty and evinced the defendant's intention to be contractually bound immediately upon the plaintiff's acceptance, constituted by its performance of the stipulated consideration.*
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> *…*
>
> *[116] The defendant did not dispute that its representatives … presented a short skit at the conference in which (it was) stated that certain models of Canon copiers would be available for purchase for $1 by BISG dealers. It submitted, however, that (it was) stated that the opportunity would arise at the end of the rental agreement or when the customer no longer required the copier, whichever was the later.*
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> *[117] It submitted that (the) presentation was of a general, rather than detailed, character.*
>
> *…*

[120] He contended that, in contrast to Carlill v Carbolic, the statements made at the conference were too vague and uncertain to amount to a contractual offer. In particular, they did not specify any acts which the plaintiff must perform in order to secure the entitlement. They were made in the course of a five minute comic skit as part of an incentive campaign and policy, and although the defendant subsequently both acknowledged and acted upon the commitment to make machines available to dealers, the address was not intended to be an offer legally binding upon performance by dealers, and would not be apprehended as such by a reasonable member of the audience.

…

[123] Further, the defendant argued that if there were an agreement, it was clear that any contractual entitlement to purchase machines for $1 did not arise until the end of the rental agreement and was restricted to current BISG dealers as at that date…

[124] The defendant submitted that, properly analysed, the "offer" was one of a number of non-contractual incentives offered to improve dealers' performance."

Her Honour found as follows:

"[169] Despite the centrality of the speech to the plaintiff's case …evidence in relation to it was extremely scant …

…

[172] The amended witness statement states that the speech "was to encourage us to use the finance services of CFA". No objection was taken to Mr Janssen's statement of CFA's purpose, although no factual basis for it was set out. The defendant did not deny that its objective was to encourage the use of its financial products. The existence of such a commercial purpose in the defendant is not, however, equivalent to a stipulated condition that the dealer must procure customers in its area to enter rental agreements with CFA as consideration for a promised reward.

…

[174] Importantly, however, were the totality of Mr Janssen's evidence to be accepted, it would not support the plaintiff's allegation that the dealer's procurement of rental agreements with CFA, or indeed any other act, was specified in the address as the consideration. An essential element of a unilateral contract of the Carlill v Carbolic class is therefore lacking.

[175] The slightness of Mr Janssen's evidence on the terms of the "$1 offer" and how the arrangement would operate over time given various contingencies, in my view also militates against a firm contractual promise. Further, the alleged successive additional contractual terms are not a substitute for sufficient certainty at the date of the alleged acceptance. There was also no persuasive evidence that the alleged additional terms were agreed upon by the parties, rather than unilaterally promulgated or imposed by the defendant. They suggest an evolving programme rather than new terms of a contract…

…

[182] Therefore, despite the additional details to which Mr Blancato testified, the defendant's presentation at the conference lacked the requisite certainty.

> *[183] More fundamentally, neither the evidence of Mr Janssen nor Mr Blancato supported the requirement "that it should be made to appear that the statement or announcement which is relied on as a promise was really offered as consideration for the doing of an act" in order to establish a unilateral contract.*
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> *[184] Although Mr Blancato stated that the $1 purchase would only apply to copiers sold through Canon BISG dealers and not by Canon directly, that is different from stating that the dealer must procure customers to enter rental agreements with CFA as quid pro quo for the entitlement to purchase ex-rental machines for $1, as alleged by the plaintiff. The stated restriction cannot be convincingly construed as a stipulation of the act required of the offeree as consideration for the benefit…".*

The result was that the plaintiff failed in at least each of the following respects to establish that a contract had come into existence:

- insufficient certainty, in particular that there was not sufficiently specified the conduct said to be the acceptance of the unilateral contract alleged;
- no intention to create legal relations, rather an "evolving programme"; and
- no relationship of *quid pro quo* between the promise and the consideration.

3. Contracts resulting from conduct

3.1 How may contracts result from conduct?

Contracts are said to result from conduct in at least the following three ways:

- a unilateral contract may be accepted by the performance by the offeree of the act contemplated by the offer, as in *Carlill v Carbolic Smoke Ball Co*;[39]
- the acceptance of a bilateral contract may be inferred from conduct;[40] and
- if it is not otherwise clear, regard may be had to the subsequent conduct of the parties to determine whether an agreement has been concluded.

We are presently concerned with the second and third of these.

3.2 Acceptance Inferred From Conduct

In *Brodgen v Metropolitan Railway Co,*[41] the House of Lords concluded that, although there had been no formal acceptance of terms and conditions, there had nevertheless been acceptance by virtue of the defendant ordering products upon the terms of the contract.

In *Empirnall Holdings Pty Ltd v Machon Paull Partners Pty Ltd,*[42] architects had undertaken work before submitting a contract to be signed. The contract was never signed but the parties conducted themselves in a manner consistent with the terms of the contract. The

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[39] [1893] 1 QB 256.

[40] *Brodgen v Metropolitan Railway Co* (1877) 2 App Cas 666.

[41] Ibid.

[42] (1988) 14 NSWLR 523.

NSW Court of Appeal held that regardless of the failure to sign a contract, its terms should apply. Kirby P (as he then was) said (at 528-30):

> *"… courts have come to conclude that sometimes, out of some circumstances, an acceptance can be inferred, notwithstanding the absence of specific assent. Alternatively, in some circumstances, the law will provide an estoppel to preclude a party from denying the existence of a contract, even though specific acceptance was not given and could not be inferred from the facts proved.*
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> *…*
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> *The circumstances in which assent may be inferred, although never specifically stated, vary with the infinite variety of facts which come before the courts in disputed contractual cases. From the facts, looked at objectively, a court may be willing to infer a party's acceptance. Various categories of cases of this kind have emerged over the years. One arises where there have been previous dealings between the parties or where something in the history of the transaction between the parties gives rise to "an inevitable inference from the conduct" of the disputing party, and from its "doing and saying nothing" for a considerable time, that it "accepted the [contract] as valid".*
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> …
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> *The relationship between the parties is also important. …The relationship between a property developer and a firm of managing architects might possibly be explained by reference to an imputed contract or one agreed to orally. But it is less likely that such parties would enter a protracted arrangement, involving a substantial building project, and large sums of money without settling in some little detail the terms of their relationship. It is in this way that the identity of the parties and the nature of their relationship may more readily give rise to the inference that they had agreed to be bound by a printed contract than would be the case, say, in dealings between private individuals having no similar commercial attributes."*

McHugh JA took a slightly different approach but reached the same conclusion (at 534-5):

> *"…the silence of an offeree in conjunction with the other circumstances of the case may indicate that he has accepted the offer: Rust v Abbey Life Assurance Co Ltd [1979] 2 Lloyd's Rep 334 at 340. The offeree may be under a duty to communicate his rejection of an offer. If he fails to do so, his silence will generally be regarded as an acceptance of the offer sufficient to form a contract. Many cases decided in United States jurisdictions have held that the custom of the trade, the course of dealing, or the previous relationship between the parties imposed a duty on the offeree to reject the offer or be bound: CMI Clothesmakers Inc v ASK Knits Inc 380 NYS 2d 447 (1975); Brooks Towers Corporation v Hunkin-Conkey (1988) 14 NSWLR 523 at 535 Construction Co 454 F 2d 1203 (1972); Alliance Manufacturing Co Inc v Foti 146 So 2d 464 (1962). But more often than not the offeree will be bound because, knowing of the terms of the offer and the offeror's intention to enter into a contract, he has exercised a choice and taken the benefit of the offer."*

3.3 Subsequent Conduct Establishing a Concluded Agreement

Problems with the offer-acceptance model

As canvassed earlier, classically an agreement is evidenced by a discrete offer and a matching acceptance, which together evidence an agreement having been concluded. However, it is often very difficult to discern these two discrete contractual components in practice from the imperfect reality of the dealings between commercial parties.

In the relatively recent decision of *Ormwave Pty Ltd v Smith,*[43] Beazley JA succinctly summarised the development of this area of contract law in the following terms (at [68]-[75]):

> *"[68] It is not necessary, in determining whether a contract has been formed, to identify either a precise offer or a precise acceptance, nor a precise time at which an offer or acceptance could be identified. As Stephen J explained in MacRobertson Miller Airline Services v Commissioner of State Taxation (Western Australia) (1975) 133 CLR 125 at 136; [1975] HCA 55:*
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> > *This doctrine, of the formation of contracts by offer and acceptance, encounters difficulties when sought to be applied, outside the realms of commerce and conveyancing, to the everyday contractual situations which are a feature of life in modern urban communities.*
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> *[69] In Brambles Holdings Ltd v Bathurst City Council (2001) 53 NSWLR 153; [2001] NSWCA 61 Heydon JA (as his Honour then was) also observed that "[o]ffer and acceptance analysis does not work well in various circumstances". He referred to the decision of MacRobertson Miller Airline Services v Commissioner of State Taxation (Western Australia) at 136–140 by way of example. Heydon JA then undertook a detailed analysis of the authorities: see [71]–[80] of his Honour's judgment.*
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> *[70] It is not necessary for present purposes to review all the authorities to which his Honour referred. However, the comments of McHugh JA (Hope and Mahoney JJA concurring) in Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd (1988) 5 BPR 11,110 at 11,117–11,118, are particularly apt. His Honour said:*
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> > *It is often difficult to fit a commercial arrangement into the common lawyers' analysis of a contractual arrangement. Commercial discussions are often too unrefined to fit easily into the slots of 'offer', 'acceptance', 'consideration' and 'intention to create a legal relationship' which are the benchmarks of the contract of classical theory. In classical theory, the typical contract is a bilateral one and consists of an exchange of promises by means of an offer and its acceptance together with an intention to create a binding legal relationship … it is an error 'to suppose that merely because something has been done then there is therefore some contract in existence which has thereby been executed'. Nevertheless, a contract may be inferred from the acts and conduct of parties as well as or in the absence of their words. The question in this class of case is whether the conduct of the parties viewed in the light of the surrounding circumstances shows a tacit understanding or agreement. The conduct of the parties, however, must be capable of proving all the essential elements of an express contract.*
> >
> > *…*
> >
> > *Moreover, in an ongoing relationship, it is not always easy to point to the precise moment when the legal criteria of a contract have been fulfilled. Agreements concerning terms and conditions which might be too uncertain or too illusory to enforce at a particular time in the relationship may by reason of the parties' subsequent conduct become sufficiently specific to give rise to legal rights and duties. In a dynamic commercial relationship new terms will be added or will supersede older terms. It is necessary therefore*

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[43] [2007] NSWCA 210.

> *to look at the whole relationship and not only at what was said and done when the relationship was first formed." (Citations omitted)*
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> *…*
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> *[72] The sometimes artificiality of precise analysis of contract formation in terms of offer and acceptance was recognised by Heydon J in Magill v Magill (2006) 226 CLR 551; [2006] HCA 51, where his Honour again observed at [210] that*
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> > *The law often develops doctrines which are useful tools of analysis in standard instances, even though they are difficult to employ in other instances. An illustration is the doctrine of offer and acceptance in relation to contract formation. That works in many factual circumstances. The fact that it does not work well, and can only be applied with some artificiality, in other sets of circumstances, has not been seen as a reason for its wholesale abandonment.*
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> *[73] The last reference in this passage from Magill was to the comments of Ormiston J in Vroon BV v Foster's Brewing Group Ltd [1994] 2 VR 32 at 82–83. In that case, Ormiston J cited with approval the comments of McHugh JA in Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd. He also cited with approval the statement of Cooke J in Meates v Attorney-General [1983] NZLR 308 at 377:*
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> > *… I would not treat difficulties in analysing the dealings into a strict classification of offer and acceptance as necessarily decisive in this field, although any difficulty on that head is a factor telling against a contract. The acid test in the case like the present 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.*
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> *[74] Ormiston J then said at 81:*
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> > *… I am prepared to accept … that agreement and thus a contract can be extracted from circumstances where no acceptance of an offer can be established or inferred and where the most that can be said is that a manifestation of mutual assent must be implied from the circumstances. In the language of para 22(2) of the Second Re-statement on Contracts: 'A manifestation of mutual assent may be made even though neither offer nor acceptance can be identified and even though the moment of formation cannot be determined'."*

The approach taken by courts

In *Anro Nominees Pty Ltd v Earlsfield Developments Pty Ltd*,[44] Heydon JA (as he then was) said:

> *"[10] So called "post contractual" conduct is admissible on the question whether a contract has been formed: Howard Smith & Co Ltd v Varawa (1907) 5 CLR 68 at 77; Barrier Wharfs Ltd v W Scott Fell & Co Ltd (1908) 5 CLR 647 at 668–669 and 672 and Brambles Holdings Ltd v Bathurst City Council (2001) 53 NSWLR 153 at [25]."*

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[44] [2009] FCA 388.

In the recent decision of *Len Di Pietro v Basjo Catering Pty Ltd,*[45] Hargrave J of the Victorian Supreme Court considered whether certain business agreements had been concluded:

> *"[151] It is necessary to determine whether, objectively considered, Mr Di Pietro, Mr Lakkis and the Zouki brothers intended to conclude an enforceable agreement between them for the sale to Mr Di Pietro of the three businesses. In determining this question, the Court may consider and take into account the terms of the pre-contract agreement, the surrounding circumstances in which the pre-contract agreement was signed (or, in the case of Mr Lakkis, the circumstances in which he did not sign the pre-contract agreement) and the subsequent conduct of the parties."*

Whilst it is permissible to have regard to subsequent conduct to determine whether a contract has been formed, there are limits to the purpose for which that conduct may be applied:

- it will not detract from a finding that an agreement had already been concluded;[46] and
- it will not establish a contract if the court has already determined that no agreement was concluded.[47]

In having regard to the conduct of the parties, there is authority that the court may check to see whether custom has been followed with respect to the conclusion of the agreement, for example by the exchange of formal contracts for the sale of land.[48]

There is also authority that substantial commercial contracts should not be found to be established by subsequent conduct.

Palmer J in *R T & Y E Falls Investments*[49] said:

> *"Commonsense has a part to play in the Court's enquiry: it is inherently improbable that commercial people will intend to bind themselves to a substantial transaction in that haphazard and imprudent fashion, so potentially productive of subsequent dispute, when they have already recognised the need for a formal contract to record the terms of the transaction."*

In *Rosebanner Pty Ltd v Energyaustralia,*[50] Ward J of the NSW Supreme Court said:

> *"[294] I note that in R T & Y E Falls Investments, Palmer J accepted that, as a general rule, when parties had been negotiating a substantial commercial transaction in the common expectation that at some stage a formal contract would*

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[45] [2008] VSC 326.

[46] Lennon v Scarlett & Co (1921) 29 CLR 499.

[47] *Mildura Office Equipment & Supplies Pty Ltd v Canon Finance Australia Ltd* [2006] VSC 42 at [185]; affirmed on appeal [2007] VSCA 112.

[48] *Allen v Carbone* (1975) 132 CLR 528.

[49] [2001] NSWSC 1027 at [50].

[50] [2009] NSWSC 43.

be brought into existence, the court should be reluctant to find a common intention that a binding informal contract should come into existence at any time prior to the execution of the formal document; especially when the terms of the alleged informal contract would have to be pieced together or implied from various conversations and from selective extracts from correspondence."

Unfortunately, beyond that it is permissible to have regard to subsequent conduct to determine whether a contract has been formed and that custom and commerciality may be relevant, it is very difficult to predict the approach a court will take in any particular circumstances.

For example, in *Geebung Investments Pty Ltd v Varga Group Investments No. 8 Pty Ltd,*[51] the New South Wales Court of Appeal was divided as to an oral agreement alleged to have been reached to settle pending litigation, as well as the significance of the parties having shaken hands. The majority found that there was a contract notwithstanding that formal terms of settlement had been intended to be prepared but had not eventuated.

It is also very often the case that there will be overlapping questions as to the intention of the parties to create legal relations, particularly whether they may have agreed to agree, and whether there is sufficient certainty.

3.4 Subsequent Conduct Case Study

Kriketos v Livschitz[52] is a recent decision of the New South Wales Court of Appeal which is an excellent example of the court having to consider the parties' conduct during negotiations, including silence and subsequent conduct, in order to determine whether an agreement had been concluded.

Background facts

McColl JA summarised the background in the following terms:

"[20] Rehab was registered on 5 February 1999. Its original directors were Marc Richard Eisman and Steven Morgan Matthews. On 20 August 1999 Rehab entered into a contract to purchase the whole of the land and improvements at 23 Pelican St, Darlinghurst for $3.6 million. The respondent [Livschitz] became a director of Rehab on 29 June 2000.

[21] Mr Eisman, Mr Matthews and the respondent were also directors and shareholders in a company, Gold's Gym Pty Ltd, which was registered on 24 February 2000. The primary judge referred to Messrs Eisman, Matthews and the respondent as "EML" because insofar as the underlying facts were concerned they had a joint proprietary interest in Gold's Gym. I shall also adopt that acronym where appropriate.

[22] In early 2000 EML obtained the Sydney rights to a franchise known as "Gold's Gym", apparently a chain of gymnasia operated in the United States of America. They intended to operate Gold's Gym from the premises at Pelican St.

[23] The appellant [Kriketos] was a director of DM Developments Pty Ltd, which was the financier of various joint venture property developments undertaken in association with a company known as SSK Holdings Pty Ltd ("SSK"). SSK was

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[51] (1995) Aust Contract Rep 90-059.

[52] [2009] NSWCA 96.

> *controlled by Mr Socrates ("Scott") Kitas. Christopher Kitas was Scott Kitas' father. At some stage in 2000 (the evidence did not disclose the precise date) Scott Kitas informed the appellant of the possibility of them acquiring a 50% share in the Pelican St building with the other 50% being owned by EML. The appellant agreed to buy a 25% interest in the company. Mr Scott Kitas "purchased" the other 25% share, albeit that Christopher Kitas was the nominal purchaser.*
>
> *[24] On 19 July 2000 a document described as the Rehab Shareholders' Deed was executed between Christopher Kitas and the appellant as to one part (the "KK" interests), EML as to the second part and Rehab as to the third part."*

The Rehab Shareholders' Deed contemplated that SSK would undertake redevelopment of the property at 23 Pelican Street, Darlinghurst, with financing provided by DM Developments Pty Ltd, and was to include a gymnasium. After construction, Rehab was required to lease the gymnasium to Gold's Gym. The rent was initially fixed by the Rehab Shareholders' Deed at $360,000 per annum but later was varied by a Variation Deed to $465,000 per annum. Subsequently, the rent was reduced back to the original amount of $360,000 per annum.

Kitas then began proceedings against Rehab and sought an order appointing a receiver and manager to the Pelican St property, or alternatively the appointment of a provisional liquidator of Rehab. Kitas complained that there had been a shortfall in the rental payments based on the proposition that the rent was $465,000 per annum. EML defended Rehab against the proceedings but Kriketos did not participate.

Around March 2002, Kriketos became interested in purchasing the Rehab shares owned by Kitas. EML were reluctant to cooperate with respect to Kriketos purchasing Kitas' Rehab shares unless they received some financial accommodation in respect of the proceeding commenced by Kitas.

The contract

It was alleged that three letters which had been exchanged comprised an agreement:

- a letter of 19 April 2002 sent "without prejudice" by EML to Kriketos proposing an agreement;
- a letter of 2 May 2002 from Kriketos to EML seeking to clarify the value of the shares held by Kitas and the balance required to be paid to EML on the purchase of the shares; and
- a letter of 6 May 2002 from EML to Kriketos providing calculations with respect to the value of Kitas' Rehab shares and the balance required to be paid to EML for its consent.

Kriketos never responded to the 6 May 2002 letter. On 26 November 2004, Kriketos purchased Kitas' Rehab shares for $525,000 without paying anything to EML.

Livschitz brought proceedings against Kriketos, seeking to enforce a contract comprised of the three letters and requiring Kriketos pay the balance to EML as consideration for EML's consent. At first instance, Neilson DCJ agreed with this view.

The court at first instance found that subsequent conduct was evidence that a contract had been concluded by the third letter.

Judgment

The appeal was unanimously allowed. McColl JA, who wrote the leading judgment, began her analysis with a comprehensive survey of the current law:

> *"[106] It is trite law that there is no contract unless two parties mutually consent to be bound one to the other by one agreement. However, as Higgins J thought it necessary to add to that statement of the law, "it is one thing for two parties to settle what are to be the terms of an agreement, if it should be made; and quite another thing to make the agreement"…*
>
> *[107] Whether a contract has been formed, and the terms of any contractual arrangement, requires objective determination…*
>
> *[108] The exercise of objective determination requires the court to consider the text of relevant documents, and also the surrounding circumstances known to participants, and the genesis, purpose and object of the transaction, but not the participants' subjective beliefs…The surrounding circumstances include the parties' relationship to one another…*
>
> *[109] "[P]ost-contractual conduct is admissible on the question of whether a contract is formed"…*
>
> *[110] The conventional approach to the question whether a contract has been formed turns on determining whether there has been offer and acceptance, that is to say, a "clear indication by one party of a willingness to be bound on certain terms, accompanied by an unqualified assent to that offer communicated by the other party"…*
>
> *…*
>
> *[113] Even on what I might call the "non-conventional" approach, in order to conclude there is a binding contract, the exchange of the three letters must be seen to have constituted the parties' mutual communication of their "respective assents to being legally bound by terms capable of having contractual effect"…*
>
> *[114] The question whether such mutual assent was communicated turns on whether "viewed as a whole and objectively from the point of view of reasonable persons on both sides, the dealings show a concluded bargain"…*
>
> *…*
>
> *[116] In Empirnall (at 528, 531), Kirby P described the process by which acceptance of an offer can be inferred notwithstanding absence of specific assent as one of "implied acceptance".*
>
> *[117] … for conduct to amount to implied acceptance of an offer, it must be "of such a character as necessarily to lead to the inference on the part of the defendants that the agreement had been accepted on the part of the Plaintiffs, and was to be acted upon by them": Brambles (at [162]) per Ipp AJA (Mason P agreeing), citing Lord Hatherley in* Brogden v Metropolitan Railway Co *(1877) 2 App Cas 666 (at 686)"…*
>
> *[118] In Empirnall (at 534-535) McHugh JA discussed the circumstances in which the silence of an offeree in conjunction with the other circumstances of the case may indicate that the offer has been accepted. Although, as I have discussed, in my view the primary judge's conclusion that the parties had reached consensus by the exchange of the three letters did not depend upon acceptance being communicated*

by Mr Roth's silence after 6 May 2002, his Honour did take that factor into account apparently as subsequent "conduct" consistent with agreement having been reached. It is useful, in those circumstances, to set out McHugh JA's remarks which cast light on the relevance of silence in contractual analysis:

> *Under the common law theory of contract, the silent acceptance of an offer is generally insufficient to create any contract: Brogden v Metropolitan Railway Co (1877) 2 App Cas 666 at 692 and Robophone Facilities Ltd v Blank [1966] 1 WLR 1428 at 1432 ; [1966] 3 All ER 128 at 131-132. After a reasonable period has elapsed, silence is seen as a rejection and not a acceptance of the offer. ... Nevertheless, the silence of an offeree in conjunction with the other circumstances of the case may indicate that he has accepted the offer: Rust v Abbey Life Assurance Co Ltd [1979] 2 Lloyd's Rep 334 at 340. The offeree may be under a duty to communicate his rejection of an offer. If he fails to do so, his silence will generally be regarded as an acceptance of the offer sufficient to form a contract ... But more often than not the offeree will be bound because, knowing of the terms of the offer and the offeror's intention to enter into a contract, he has exercised a choice and taken the benefit of the offer. In Laurel Race Course Inc v Regal Construction Co Inc 333 A 2d 319 (1975) a contractor proposed that it would do additional work upon the basis that, if the work was the result of its defective workmanship under the original contract, there would be no charge. Otherwise the work would be charged on a 'cost-plus' basis. The building owner made no reply to this offer. The contractor commenced work on the job to the knowledge of the building owner who was held bound by the terms of the offer. Speaking for the Court of Appeals for Maryland, Judge Levine said (at 329):*
>
> > *... Where the offeree with reasonable opportunity to reject offered services takes the benefit of them under circumstances which would indicate to a reasonable person that they were offered with the expectation of compensation, he assents to the terms proposed and thus accepts the offer.*
>
> *This formulation states acceptance in terms of a rule of law. However, the question is one of fact. A more accurate statement is that where an offeree with a reasonable opportunity to reject the offer of goods or services takes the benefit of them under circumstances which indicate that they were to be paid for in accordance with the offer, it is open to the tribunal of fact to hold that the offer was accepted according to its terms. A useful analogy is to be found in the "ticket cases" where an offeree, who has or ought to have knowledge of the terms of a contract of carriage or bailment, is generally bound unless he raises objection: cf Thornton v Shoe Lane Parking Ltd [1971] 2 QB 163 at 169 and MacRobertson Miller Airline Services v Cmr of State Taxation (WA) (1975) 133 CLR 125 at 136-140. The ultimate issue is whether a reasonable bystander would regard the conduct of the offeree, including his silence, as signalling to the offeror that his offer has been accepted. (emphasis added)*

[119] In each case "the inference from silence, if any, must depend on the facts of the case and on common sense"…

[120] In Air Great Lakes Pty Ltd v K s Easter (Holdings) Pty Ltd (1985) 2 NSWLR 309 (at 326) Mahoney JA identified three questions to consider in determining whether parties have made a binding contract: " ... did the parties arrive at a consensus?; (if they did) was it such a consensus as was capable of forming a

binding contract?; and (if it was) did the parties intend that the consensus at which they arrived should constitute a binding contract?" [citations omitted]

With respect to the three letters, her Honour held that the letters themselves did not constitute an agreement, and that the parties' conduct suggested that there was no *consensus ad idem*:

"[147] It is relevant to take into consideration that the three letters were written by solicitors. They were not written in terms indicating the correspondence itself would constitute agreement. Mr Roth had early indicated he wanted a "written agreement", presumably meaning a final document which recorded with precision any agreement reached. Secondly, Mr James' first letter described its contents as a proposal. It was not a clear indication of willingness to be bound on certain terms. Furthermore it omitted what a reasonable person would consider a critical issue, the price the appellant was to pay for the Kitas shares.

…

[151] In my view the appellant's submission that, in the circumstances, the 6 May 2002 letter was a new offer should be accepted. Mr Roth never responded to it and, in my view, a reasonable person in the parties' positions would regard his silence in that respect as consistent with the appellant rejecting the EML proposal once it was laid out in its entirety: Empirnall (at 534). Read as a whole, and taking the circumstances into account, the correspondence did not manifest the mutual assent necessary to establish the parties had reached a consensus.

…

[157] The second basis on which the primary judge concluded that consensus had been reached by the exchange of the three letters lay in his analysis of the parties' conduct after 6 May 2002, including the appellant filing an affidavit in the Supreme Court proceedings, which conduct he concluded was consistent, and "not inconsistent", with the agreement the respondent propounded. His Honour also found he could more readily draw inferences from the subsequent conduct and the lack of response to the 6 May 2002 letter because neither the appellant nor Mr Roth gave evidence.

…

[160] Turning to the subsequent conduct, the first point to make is that neither its consistency or lack of inconsistency with the pleaded agreement was sufficient to support a finding that consensus had been reached on or about 6 May 2002. The test his Honour ought to have applied was whether the parties' conduct after 6 May 2002 "necessarily" led to the inference that consensus had been reached, or that that conduct was referable only to the agreement the respondent propounded: see the authorities collected above (at [117]).

[161] In my view the conduct of the parties after the 6 May 2002 letter did not support the conclusion that there had been mutual assent to the EML proposal.

[162] I do not accept that a reasonable observer would conclude, as did the primary judge, that Mr Roth's failure to respond to the 6 May letter indicated that "some accommodation" had been reached. Rather, as I have said, Mr Roth's silence was consistent with rejection.

[163] Next, the fact that the appellant filed an affidavit opposing the relief Mr Kitas sought in the Supreme Court proceedings and propounding his desire to purchase

the Kitas shares was, in my view, equivocal on the question whether a concluded agreement had been reached.

…

[175] The primary judge erred in finding that the subsequent conduct was evidence that a consensus had been reached on or about 6 May 2002."

4. The Masters v Cameron Question and Letters of Intent

4.1 Masters v Cameron

In *Masters v Cameron*[53] an agreement was signed between a vendor and a purchaser, which included a clause that the:

> *"…agreement is made subject to the preparation of a formal contract of sale which shall be acceptable to my solicitors on the above terms and conditions."*

After a deposit had been paid, the purchasers failed to proceed with the sale. The vendor then sued on the basis that there was an agreement. The purchasers argued that the relevant clause contemplated the signing of a formal agreement and until that had occurred, there was no contract. The High Court agreed with this argument after establishing that there are 3 categories of conditional agreements.[54]

First Category – a binding document detailing all the terms of the agreement

In relation to the first category, the High Court said:[55]

> *"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.*
>
> *…*
>
> *…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…"*

Second Category – a binding document detailing all the terms of the agreement but performance of some of the terms is conditional on the execution of a formal document

In relation to the second category, the High Court said:

> *"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.*

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[53] (1954) 91 CLR 353.

[54] at 360-2.

[55] Ibid.

…

…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."

Third Category – a non-binding document subject to a formal contract

In relation to the third category, the High Court said:

"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.

…

Cases of the third class are fundamentally different. They are cases in which the terms of agreement are not intended to have, and therefore do not have, any binding effect of their own…. The parties may have so provided either because they have dealt only with major matters and contemplate that others will or may be regulated by provisions to be introduced into the formal document, … or simply because they wish to reserve to themselves a right to withdraw at any time until the formal document is signed."

Fourth Category – a controversy

In recent years, there has been a debate as to the existence of a fourth category, similar to the first and second categories, arising where the parties agree to be bound immediately, but also intend to enter into a new agreement including additional terms which is to be substituted for the original agreement in due course.[56]

In *Sinclair Scott & Co Ltd v Naughton,*[57] the majority consisting of Knox CJ, Rich and Dixon JJ said (at 317):

"The case is not one in which the parties were content to be bound immediately and exclusively by the terms which they had agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms. Such a possible case is mentioned by Lord Loreburne, in Love and Stewart Ltd v Instone and Co Ltd., *(1917) 33 T.L.R 475 at p 476 ..."*

In *John R Keith Pty Ltd v Multiplex Constructions (NSW) Pty Ltd & Anor,*[58] Einstein J of the NSW Supreme Court acknowledged the existence of the fourth category and provided a concise history of its development:

"[218] As the defendants point out in their written submissions, the seeds of what has now been called the "fourth class" were sown in the earlier case of Sinclair Scott Co Ltd v Naughton (1929) 43 CLR 310…

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[56] See *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) 40 NSWLR 622, McClelland J); *Tern Minerals NL v Kalbara Mining NL* (1990) 3 WAR 486 at 494–5 per Ipp J; *Summertime Holdings Pty Ltd v Environmental Defender's Office Ltd* (1998) 45 NSWLR 291 at 294–5 per Young J; *Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd* (2000) 22 WAR 101 at 110 per Ipp J; and *Australian Securities and Investments Commission v Edwards* (2005) 220 ALR 148 at 167 per Barrett J.

[57] (1929) 43 CLR 310 at 317.

[58] [2002] NSWSC 43 at [218]-[237].

[219] In Love & Stewart Ltd v S Instone & Co Ltd (1917) 33 TLR 475, his Lordship Lord Loreburn stated at 476:

> *"It was quite lawful to make a bargain containing certain terms with which one was content, dealing with what one regarded as essentials, and at the same time to say that one would have a formal document drawn up with the full expectation that one would by consent insert in it a number of further terms. If that were the intention of the parties, then a bargain had been made, nonetheless that both parties felt quite sure that the formal document could comprise more than was contained in the preliminary bargain."*

[220] In Baulkham Hills Private Hospital Pty Ltd v G R. Securities Pty Ltd (1986) 40 NSWLR 622 McClelland J by reference to Sinclair Scott and Co Ltd v Naughton (1929) 43 CLR 310 referred to a fourth class in terms of Masters v Cameron, namely the situation where the parties were content to be bound immediately and exclusively by the terms which they had agreed upon, whilst expecting to make a further contract in substitution for the first contract containing, by consent, additional terms.

[221] On the issue which arose in Baulkham Hills of whether or not there was a binding contract, McClelland J at 627 put the manner as follows:

> *"There was a binding contract, if and only if, by the exchange of letters the parties mutually communicated their respective assents to being legally bound by terms capable of having contractual effect: see the discussions in Film Bars Pty Ltd v Pacific Film Laboratories Pty Ltd (1979) 1 BPR 9251 at 9254ff and Air Great Lakes Pty Ltd v KS Easter (Holdings) Pty Ltd (1985) 2 NSWLR 309. In the last mentioned case Mahoney J A (at 326) identified three questions which it is often useful to consider in such a context as the present, namely "....did the parties arrive at a consensus?; (if they did) was it such a consensus as was capable of forming a binding contract?; and (if it was) did the parties intend that the consensus at which they arrived should constitute a binding contract?"*

[222] On appeal to the Court of Appeal, McLelland J's decision was affirmed on the basis of the principle quoted above in Sinclair, Scott. In G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd (1986) 40 NSWLR 631, the Court of Appeal held that,

> *"...the decisive issue is always the intention of the parties which must be objectively ascertained from the terms of the document when read in the light of the surrounding circumstances: Godecke v Kirwan (1973) 129 CLR 629 at 63; Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd (1985) 2 NSWLR 309 at 332-4, 337. If the terms of a document indicate that the parties intended to be bound immediately, effect must be given to that intention irrespective of the subject matter, magnitude or complexity of the transaction." (per McHugh JA as his Honour then was at 634E-F, with whom Kirby P and Glass JA agreed) [emphasis added]*

[223] As the defendants point out, the fourth class has now passed into common parlance insofar as the courts are concerned and is referred to regularly as an accepted classification: see Tern Minerals NL v Kalbara Mining NL (1990) 3 WAR 486; Heysham Properties Pty Ltd v Action Motor Group Pty Ltd & Ors (1996) 14 BCL 145; Telstra Corporation Ltd v Australis Media Holdings (1997) 24 ACSR 55; Brunninghausen v Galvanics (1999) 46 NSWLR 538.

[224] I accept that regardless of classification, the principle that is now recognised is that there can be an informal contract with the expectation that other terms will be negotiated and by consent included in the formal document. That is, to say that such

> *further negotiations and activity regarding other terms is still to take place does not mean the existing informal contract is not binding: Anaconda Nickel Ltd v Tarmoola Australia Pty Ltd (2000) 22 WAR 101 (per Ipp J at 110-111).*
>
> *[225] Most recently, the fourth class was considered in Graham Evans Pty Ltd v Stencraft Pty Ltd 16 BCL 335 [Full Federal Court (French, Whitlam and Dowsett JJ) and see also transcript of special leave application which was refused]. Evans brought an action against Stencraft claiming damages for breach of contract. The claim was dismissed at first instance. Evans appealed to the Full Federal Court. The Full Federal Court, in reversing Spender J at first instance, considered Masters v Cameron and applied Baulkham Hills and in so doing upheld the appeal unanimously. The Full Court held that parties may be bound immediately by the terms, which they agree upon whilst expecting to negotiate the terms of, and make a further contract in substitution for, the first contract."*

Some academic commentators have rejected the notion of a fourth category on the basis that *Masters v Cameron* set out three markers on a conceptual continuum in order to aid the determination whether or not an agreement would be binding.[59] Given that Sir Owen Dixon sat on the bench for both *Sinclair Scott* and *Masters v Cameron*, it has been argued that the fact that his Honour did not make reference to a fourth category suggested that it was a category which fell within the scope of the three categories expressed, in particular the first category which contemplates that a "formal contract will be longer, more detailed and cover further issues, providing the terms already agreed are not changed."[60]

Another academic commentator has taken the view that although the label of "fourth category" was unfortunate, it has served a useful purpose in drawing *"attention to the potential for enforcement of a preliminary agreement full intended to be binding that might otherwise be classified…as involving an invalid 'agreement to agree'."*[61]

In *Helmos Enterprises Pty Ltd v Jaylor Pty Ltd*, with respect to attacks by academics on the existence of this fourth category, Young CJ in Eq commented:[62]

> *"[69] There has been recent academic discussion as to whether there really is a fourth class to be added to the three specified in Masters v Cameron; see the article in (2004) 20 JCL 156 by Peden, Carter and Tolhurst, "When Three Just Isn't Enough". However, 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. Indeed no-one gave it more than passing reference in the instant case."*

Other judges have sought to avoid the academic debate. Giles J said in *Tasman Capital Pty Ltd v Sinclair and Anor:*[63]

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[59] Elisabeth Peden, J W Carter and G J Tolhurst, “When Three Just Isn't Enough: the Fourth Category of the ‘Subject To Contract’ Cases” (2004) 20 JCL 156.

[60] (2004) 20 JCL 156 at 165.

[61] D W McLauchlan “In Defence of the Fourth Category of Preliminary Agreements: Or are there Only Two?” (2005) 21 JCL 326.

[62] [2005] NSWCA 235 at [69].

> *[26] I do not enter into the debate over categories found…. The Masters v Cameron (1954) 91 CLR 353 categories, and a possible fourth category, are intellectual aids, but whether parties have come to a binding agreement is a matter of their objectively ascertained intention. Categorisation does not greatly contribute to the decision in the particular case, which is concerned with finding what agreement, if any, the parties came to.*
>
> *[27] A binding agreement can be reached with the contemplation, even intention, that what is agreed will later be recorded in a formal document; it can also be reached with the contemplation or intention that what is agreed will later be supplemented by refinement or by agreement on matters which have been left for future agreement. That lies behind the reference in Sinclair, Scott & Co v Naughton … and the numerous cases which have recognised the so-called fourth category. If the parties have come to a binding agreement, it does not matter that there may be later refinement or additional agreement."*

In *Australian and International Pilots Association v Qantas Airways Limited (ACN 009 661 901)*[64] Gray J of the Federal Court commented as follows:

> *"[75] There must be some doubt as to whether a case described in these terms falls within a fourth class, additional to those described in Masters v Cameron. Assuming the existence of a binding agreement, it is always open to the parties to that agreement to vary it by adding additional terms. Viewed in that light, the so-called fourth class appears not to differ from the first or second classes referred to in Masters v Cameron."*

Whilst the categorisation debate is interesting, as D W McLauchlan has observed, it has served to confirm that "there can be an informal contract with the expectation that other terms will be negotiated and by consent included in the formal document. That is, to say that such further negotiations and activity regarding other terms is still to take place does not mean the existing informal contract is not binding."[65]

4.2 Letters of Intent

Letters of intent are commonly employed by commercial parties and are a classic example of a conditional agreement of the type contemplated in *Masters v Cameron*. They have recently been described in the following terms:[66]

> *"Small sale of goods transactions are relatively simple with a short negotiating period because there are only a few essential terms to be agreed upon. Large transactions, however, such as engineering and construction contracts, contracts for the exploitation of resources and joint venture contracts are often very complicated and the negotiation period is lengthy. This is due to the preliminary investigations which must be made before contracting, for example, market research and feasibility studies to establish the viability and potential profitability of the*

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[63] [2008] NSWCA 248 at [26]-[27].

[64] [2008] FCA 1972.

[65] D W McLauchlan “In Defence of the Fourth Category of Preliminary Agreements: Or are there Only Two?” (2005) 21 JCL 286 at 297.

[66] M Furmston, "Letters of Intent and Other Preliminary Agreements" (2009) 25 *Journal of Contract Law* 95. See this article for an excellent discussion on letters of intent and their treatment in other jurisdictions.

transaction, consultation with financial institutions in order to raise the necessary capital and arrangements and consultation with potential subcontractors.

Parties who have a long way to go before they can reach complete agreement often make preliminary agreements. Such agreements appear under a variety of names such as 'memorandum of understanding', 'heads of agreement', 'letter of understanding', 'agreement in principle', 'memorandum of intent', 'instruction to proceed'. The term 'letter of intent' is a generic one to cover all such preliminary documents. The legal forms of these preliminary agreements are as diverse as the names."

4.3 What is binding?

The general rule is that conditional agreements and letters of intent are not to be treated as contractual, though the facts of the case may provide otherwise.[67]

In *Abigroup Contractors Pty Ltd v ABB Service Pty Ltd (formerly ABB Engineering Construction Pty Ltd),*[68] the New South Wales Court of Appeal had to consider whether a letter of intent to a subcontractor was binding. The letter in question stated, amongst other things, that:

- acceptance is conditional upon the parties entering into a formal subcontract;
- commencement by the subcontractor is deemed to be full acceptance of the terms of this subcontract agreement and confirms the existence of a subcontract between our two companies; and
- where work commences prior to the execution of the subcontract agreement, no monies will become due and payable until the subcontract agreement has been executed.

Despite the performance of work by the subcontractor, the Court of Appeal concluded that the letter was not enforceable, in part because:

> *"[68] The conduct of the parties … was not that of offeror and acceptor of a commencement contract. They continued negotiations, and got on with the works as a practical matter not withstanding that they were still considerably apart as to the terms on which they would contract…"*

A different conclusion was reached in *Diamond Build Ltd v Clapham Park Homes Ltd.*[69] Clapham Park Homes Ltd (**CPH**) requested Diamond Build Ltd (**Diamond**) to tender for refurbishment and regeneration works to properties in London. The project specification required the contract between the parties to be executed as a deed and to be on a JCT Intermediate Form of Contract, 2005 Edition, with further amendments. The parties agreed on the principal contractual terms and a letter of intent was sent by CPH and countersigned by Diamond. The letter of intent made provision for CPH to pay Diamond's reasonable costs, subject to a cap.

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[67] *LMI v Baulderstone* [2001] NSWSC 886, where a heads of agreement document was found to be binding because it stated that it was binding despite a further more formal agreement being contemplated.

[68] [2004] NSWCA 181.

[69] [2008] EWHC 1439.

Three months after work had commenced, CPH sent out contractual documents which Diamond did not return. CPH became concerned due to delays and defective performance by Diamond. It subsequently gave notice to Diamond that no further work should be carried out under the letter of intent.

Diamond disputed CPH's right to terminate, contending that the letter of intent had been overtaken and that a contract had come into in existence between the parties on the terms of the JCT 2005 Form of Contract and that therefore any termination had to be made on those terms.

The Court's judgment included:

> *"Primarily, the issue which arises in this case is a question of construction of the Letter of Intent. There has been a substantial amount of authority about letters of intent, particularly in the context of construction contracts. Mr Justice Robert Goff (as he then was) had to consider such a case in British Steel Corporation v Cleveland Bridge & Engineering Co Ltd (1981) 24 BLR 94. He said this:*
>
> > *'Now the question whether in a case such as the present any contract has come into existence must depend on the true construction of the relevant communications which have passed between the parties and the effect (if any) of their action pursuant to those communications. There can be no hard and fast answer to the question whether a letter of intent will give rise to a binding agreement; everything must depend on the circumstances of the particular case. In most cases where work is done pursuant to a request contained in a letter of intent, it will not matter whether a contract did or did not come into existence; because if the party who has acted on the request is simply claiming payment, his claim will usually be based upon a quantum meruit, and it will make no difference whether the claim is contractual or quasi-contractual. Of course, a quantum meruit claim (like the old actions for money not received and for money paid) straddles the boundaries of what we now call contract and restitution; so the mere framing of a claim as a quantum meruit claim, or a claim for a reasonable sum, does not assist in classifying the claim as contractual or quasi–contractual. But where, as here, one party is seeking to claim damages for breach of contract, the question whether any contract came into existence is of crucial importance."*
>
> *…*
>
> *Of course, in the current case there was no material disagreement between the parties as to the terms of the contract, at the date of the revised Letter of Intent…*
>
> *…*
>
> *It is of course necessary in all cases involving letters of intent to construe the letter of intent to see whether it falls within one of several categories. There can be letters of intent which do not give rise to a contract at all. There are others which do give rise to a simple contract in themselves and are applicable pending the execution of a formal contract. There are others which are a contract so far as they go, but not subject to the entering into of a formal contract.*
>
> *…*
>
> *I now turn to the construction of the Letter of Intent. The first question to consider is whether from its terms and its acknowledgment and acceptance by DB the Letter of Intent gave rise to a contract in itself. I have no doubt that it did give rise to a (relatively) simple form of contract. My reasons are as follows:*

(a) Whilst the first paragraph merely confirms an intention to enter into a contract, the second paragraph effectively asks DB to proceed with the work.

(b) There is an undertaking in effect pending the execution of a formal contract to pay for DB's reasonable costs, albeit up to a specific sum.

(c) The fact in the penultimate paragraph that the undertakings given in the letter are to be "wholly extinguished" upon the execution of the formal contract point very strongly to those undertakings having legal and enforceable effect until the execution of the formal contract.

(d) The fact that the Specification referred to in the Letter required a contract under seal demonstrates that the parties were operating with that in mind.

(e) The very fact that DB was asked to (and did) sign in effect by way of acceptance the Letter of Intent points clearly to the creation of a contract based on the terms of the Letter of Intent itself.

Although this is a simple contractual arrangement, it has sufficient certainty: there is a commencement date, requirement to proceed regularly and diligently, a completion date, an overall contract sum and an undertaking to pay reasonable costs in the interim."

The Court found that the letter of intent, including the cap on Diamond's entitlements, continued in force because the parties had not entered into the formal contract.

4.4 Letter of Intent Case Study

In *Sagacious Procurement Pty Ltd v Symbion Health Ltd (Formerly Mayne Group Ltd)*[70] the New South Wales Supreme Court of Appeal considered whether a letter of intent was binding.

Background Facts

The appellant, Sagacious Procurement Pty Ltd (**Sagacious**), was a small company providing computer based procurement services. The respondent was a substantial public company which owned and operated private hospitals. Throughout the relevant period the respondent operated under a number of names including Mayne Nickless Ltd and Mayne Group Ltd (**Mayne**).

The relationship between the two parties began in April 1999 when Sagacious put forth a proposal to Mayne describing its eProcurement services and the advantages for Mayne, who had catering activities with a budget of well over $20 million.

After several meetings and negotiations, Sagacious sent a letter to Mayne dated 20 December 1999 detailing a proposal for a two-year Strategic Alliance Agreement (**SAA**). A resulting Heads of Agreement was created on 24 January 2000 whereby the parties agreed to enter into a SAA. In July 2000, the SAA was entered into for a period of two years, commencing on 1 August 2000.

Under the SAA, there was to be an "implementational phase" which was to be finalised by 24 September 2000, however it was agreed to be extended. By a letter dated 29 March 2001, Mayne agreed to continue the implementational phase but required changes to the SAA.

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[70] [2008] NSWCA 149

On 18 January 2002, Sagacious wrote to Mayne recording the rate that Sagacious would be paid per patient day rate, which was unprofitable.

In March 2002, Sagacious made a PowerPoint presentation to Mayne with respect to a possible contract renegotiation and an extension of the SAA which was then due to expire on 31 July 2002.

On 16 April 2002, Sagacious sent a letter to Mayne (**April letter**) which was ultimately to be at the centre of the dispute. It was a lengthy and detailed letter and was signed by both parties.

The April letter included:

> *"This proposal merges all of the terms and conditions which have been negotiated and agreed to by Mayne and Sagacious Procurement Pty Limited ("Sagacious"). Accordingly, this letter supersedes all previous correspondence in relation to our contract renegotiation discussions to date and the presentation to Mayne Executives of 28 March 2002.*
>
> *…*
>
> *1.3 Condition 3 – Operational Requirements*
>
> *…*
>
> *(h) Sagacious and Mayne acknowledge this agreement (and the final Service Level Agreement) will include provisions, or similar in intent, to the July 2000 Strategic Alliance Agreement. Such provision will include:*
>
> *Subcontracting Dealings with 3rd parties*
>
> *Conflicts of Interest*
>
> *Intellectual Property*
>
> *Volume Rebates*
>
> *Communication Costs*
>
> *Fees are inclusive*
>
> *Taxes generally*
>
> *GST*
>
> *Termination*
>
> *Obligation to act in good faith*
>
> *Confidentiality*
>
> *Permanent Disclosure*
>
> *Audit Rights*
>
> *Dispute Resolution*

7. MISCELLANEOUS

…

(b) The individual components of the proposal, as outlined above (sections 1, 2, 3, 4, 5, 6 and 7) are interdependent in terms of the rights and obligations imposed upon Mayne and Sagacious. For the avoidance of doubt, it is understood that neither Sagacious nor Mayne can arbitrarily remove any term or condition in the sections outlined above.

(c) Sagacious and Mayne acknowledge and confirm that they are bound by these terms and conditions and will act in good faith to expedite the finalisation of the Service Level Agreement which will be provided to Sagacious by Mayne."

After the April letter, Mayne prepared a draft letter to Sagacious in the nature of a letter of intent, and a Product Supply Agreement based on Mayne's standard forms. The draft letter of intent thanked Sagacious for its April letter and said:

> *" We are pleased to advise that, conditional to your acceptance of the terms and conditions of Supply Agreement 10105-C (attached), Sagacious Procurement Pty Limited has been successful as the ongoing supplier of catering supplies to Mayne.*
>
> *The appointment of Sagacious Procurement as Mayne's supplier of catering products and related services is subject to the parties executing an agreement in a form satisfactory to Mayne…."*

Sagacious and Mayne then discussed the draft letter and agreed changes, including to the first paragraph above:

> *"We are pleased to advise that, conditional to your acceptance of the terms and conditions of Supply Agreement 10105-C (attached), Sagacious Procurement Pty Limited has been successful as the ongoing supplier of catering supplies to Mayne. This agreement (based on your proposal on 16 April 2002) supersedes the strategic Alliance [sic] of July 2000 as of January 2002."*

The letter of intent was then formally sent on 14 May 2002.

Mayne purported to terminate Sagacious in July 2002.

Issue

The central issue in dispute was whether the April letter from Sagacious to Mayne, which was countersigned signed on behalf of Mayne, constituted a binding contract for the provision of eProcurement services from Sagacious for the catering activities in Mayne's hospitals.

At first instance, Einstein J held that a there was no binding contract. He found that the April letter fell within the third category as described in *Masters v Cameron*. Sagacious appealed, arguing that the letter fell within the fourth category.

Judgment

The main argument raised by the appellants was that the trial judge had placed undue reliance on matters occurring before and after the signature of the April letter, rather than looking to the terms of the April letter.

Giles JA noted this argument and laid down some fundamental principles before embarking upon a close analysis:

> *"[65] It was common ground that whether the parties intended immediately to be contractually bound was to be determined objectively, according to the intention disclosed by their words and conduct. It is sufficient to refer to Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd (1988) 18 NSWLR 540 at 548-9…*
>
> *…*
>
> *[67] As I have indicated, Sagacious submitted that the trial judge should not have looked beyond the April letter. It submitted that what it described as "extra-contractual evidence" had no significance, because the April letter was sent as a "proposal" which "merges all the terms and conditions which have been negotiated and agreed to" and "supersedes all previous correspondence in relation to our contract renegotiation to date", and was signed on behalf of Mayne to "ac-knowledge and accept the terms and conditions outlined above". It drew attention to the reference by Gleeson CJ in Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd at 549-50 to a case where the parties had signed a single document containing an expression such as "subject to contract" where the outcome "will ordinarily turn on the construction of the single document". It referred to the significance of signature of a document as a commitment to its terms, even if the terms were not known or understood, as explained in Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd [2004] HCA 52 ; (2004) 210 CLR 165 at [40]-[45] per Gleeson CJ and Gummow, Hayne, Callinan and Heydon JJ. It said that the parties' contractual intention should therefore be found only by regard to the April letter.*
>
> *[68] Where the question is whether a document constitutes a legally binding contract, McHugh JA said in G R Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd at 634 that "the decisive issue is the intention of the parties which must be objectively ascertained from the terms of the document when read in the light of the surrounding circumstances". However, there is the prior question whether the document is the sole repository of the parties' contractual intention. A formal document expressed to be "subject to contract", for example, may provide that starting-point, but it may nonetheless be shown that a legally binding contract was not intended. McHugh JA gave examples in Air Great Lakes Pty Ltd v K S Easter (Holdings) Pty Ltd (1985) 2 NSWLR 309 at 336-7, and said that a party may prove that before signing an agreement the signatories agreed that it did not constitute a binding contract and that "the intention to be bound is a jural act separate and distinct from the terms of their bargain".*
>
> *[69] The answer to what can generally be described as a Masters v Cameron question is not necessarily found in a single document. The intention of the parties may be found in a series of communications, or it may be shown that the signed document is only part of their putative contractual relationship. Further, in ascertaining the intention of the parties, whether from a series of communications or from a single document, regard can be had to the commercial circumstances in which the parties exchanged their communications or arrived at the document and to the subject matter of the putative contract. The objective intention of the parties is fact-based, found in all the circumstances including "by drawing inferences from their words and their conduct in the making of [their] agreement": Allen v Carbone (1975) 132 CLR 528 at 532 per Stephen, Mason and Murphy JJ; see also Australian Broadcasting Corporation v XIV Commonwealth Games Ltd at 548 per Gleeson CJ. Regard can also be had to the conduct of the parties after the occasion of the putative contract, to cast light on the meaning of the communications in question*

and otherwise on whether they intended immediately to be contractually bound, of which I say more later in these reasons."

Giles JA then expressed the view that:

> *"[70] Even in construing the April letter as a contract, regard could be had to evidence of surrounding circumstances. Putting that aside, I do not think the signature of the April letter closed off regard to the circumstances in which the letter was sent and signed and to the conduct of the parties thereafter. The prior question remained. Although Mr Dalton signified Mayne's acknowledgment and acceptance of "the terms and conditions outlined above", where there is a Masters v Cameron question it must still be asked whether what was thereby signified was with the intention that the parties be immediately contractually bound on those the terms and conditions. The parties may have agreed, but what had they agreed? To confine attention to the terms of the April letter begs the question."*

His Honour then noted that although there were strong indicators to suggest that the parties did intend the letter to constitute a binding contract, there were contra-indicators within the April letter to suggest that the agreement recorded was made upon terms and conditions for a contract in advanced negotiations but that was yet to be finalised:

> *"[73] Some of the matters to which I will refer bring into consideration one of the "principles" found in the cases, a formulation by Kirby P in Geebung Investments Pty Ltd v Varga Group Investments No 8 Pty Ltd (1995) 7 BPR 97578 at 14,569 being that "[t]he existence of matters of importance on which the parties have not reached consensus in their informal agreement will render it less likely that they intended immediately to be bound before the execution of a formal document". It is ordinary reasoning: in Australian Broadcasting Corporation v XIV Commonwealth Games Ltd at 548 Gleeson CJ said that "as a matter of fact and commonsense" the more numerous and significant the areas in respect of which the parties had failed to reach agreement, the slower a court will be to conclude that they had the requisite contractual intention. And the ordinary reasoning can extend to where the parties have failed to express their agreement clearly as well as where they have failed to reach agreement; put another way, failure to reach agreement includes where there is obscurity or incompleteness in the agreement. While the courts will endeavour to give effect to a contract made between businessmen notwithstanding that its terms have not been fully or well stated, that the terms have not been fully or well stated is material to whether a contract was made."*

There were other indicators which, in Giles JA's view, suggested that the letter did not constitute a binding contract:

- Paragraph 1.3(h) of the April letter incorporated an acknowledgment that "this agreement (and the final Service Level Agreement) will include provisions, or similar in intent, to the July 2000 Strategic Alliance Agreement". In short, his Honour took the view that this paragraph underlined that the final Service Level Agreement was to come.

- Further, provisions to be included, which were vital and important to a contract of this magnitude, were left unclear. It was ambiguous as to what the words "similar in intent" to the Strategic Alliance Agreement meant, and the list was inclusory rather than definitive. Giles JA held that "obscurity is an indicator that the parties did not intend immediately to be bound."

- There were terms of adjustment indicating that a contract was to be made after the trial period had concluded taking into consideration adjustments to the proposed rates.

- Paragraphs 7(b) and (c) when read together, suggested there were to be further negotiations and the execution of a formal contract, which could change the terms of the contract as long as the change was not arbitrary.

- There were an indeterminate number of other matters which had been left undetermined.

- Mayne was under no commercial pressure to enter into a binding long-term contract.

Subsequent communications between the parties also suggested that there was no agreement. Giles JA surveyed the established principles and noted:

> *"[102] The juridical basis on which the subsequent communications bear upon contractual intention may not be settled.*
>
> *[103] In Film Bars Pty Ltd v Pacific Film Laboratories Pty Ltd (1979) 1 BPR 9251 McLelland J suggested at 9255-6 that the probative value of subsequent communications lay in the light they shed on "the proper interpretation of the earlier communications alleged to constitute the contract", such as by showing continued negotiations whereby the alleged contractual dealings could not properly be interpreted as mutual assents to be bound; his Honour said they could also be admissions by conduct of the existence or non-existence of a subsisting contract, with the probative force "vary[ing] inversely with the strength of the available direct evidence of the matters in question".*
>
> *[104] Interpretation of the earlier communications may not be an ideal description of the use of the subsequent communications on the first basis to which his Honour referred. It has been put a little differently in other cases. In Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd at 548 Gleeson CJ spoke of "interpretation and understanding of the earlier communications in that it constitutes an important source of information as to what are matters incidental, or for that matter essential, to a transaction of the nature in question". In Geebung Investments Pty Ltd v Varga Group Investments No 8 Pty Ltd one of Kirby P's "principles" was –*
>
> > *4. In order to determine in what areas the parties were, and were not, in agreement, and what matters they considered necessary in order for an agreement to exist, it is legitimate to examine their subsequent conduct. Where correspondence between the parties after an informal agreement refers to important terms and conditions not mentioned during that informal discussion, it may more readily be inferred that the earlier discussion was simply a preliminary negotiation and not a binding agreement;*
>
> *[105] I respectfully suggest that subsequent communications are not simply aids to interpretation, or a source of information as to matters with which a concluded contract should deal. Their probative value may be more direct. To repeat, the objective intention of the parties is fact-based, and found in all the circumstances. That in their subsequent communications the parties have continued in negotiations, or have expressed the common understanding that they are not legally bound unless and until a formal contract is executed, is of itself probative as to their contractual intention: see Howard Smith and Co Ltd v Varawa, stating simply that any statements or conduct inconsistent with the existence of a concluded contract are relevant.*
>
> *[106] The basis of subsequent communications as admissions is very different. It does not depend on communication between the parties, and that basis gives scope*

for evidence of, for example, a party's internal memoranda saying or less directly conveying that there is or is not a concluded contract. Admissions bearing upon contractual intention present difficulties. As Gleeson CJ said in Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd at 550, "it will often be necessary to identify with some care the fact which is said to have been admitted". What is said to be admitted may be a relatively straightforward fact, for example that A discussed with B the price for goods. But if a matter of mixed law and fact is involved, or the application of a legal standard, admissibility may be more contentious.. "

Sagacious proffered the view that intention to make a binding contract was supported by:

- Sagacious billing Mayne from 1 May 2002 for two months in advance and Mayne paying Sagacious two months in advance;
- the regional hospitals having been included in Sagacious' eProcurement services and its billing; and
- new national menus having been introduced from 6 May 2002.

Giles JA acknowledged these considerations but observed other conflicting factors:

- The provision by Mayne to Sagacious of the draft Product Supply Agreement and the letter of intent, and their acceptance by Sagacious as the next steps, conveyed that there was at that point no binding contract pursuant to the April letter;
- The letter of intent did not treat the draft Product Supply Agreement as the replacement for a currently binding contract found in the April letter; and
- Other than by billing and payment consistent with the April letter, Sagacious did not in important communications between itself and Mayne treat the April letter as the embodiment of a present contractual relationship.

Conclusion

Giles JA concluded:

"[117] As is not uncommon, there are indicators for and against a binding contract constituted by the April letter. I do not think the answer to the question is found from the April letter alone. In my opinion the circumstances in which the letter was sent and signed, the terms of the letter and the nature of the putative contract are on the whole contrary to the requisite contractual intention. The billing and payment consistent with the April letter is material, but businessmen not un-commonly act upon an anticipated contractual relationship prior to the contract. The subsequent communications otherwise tend quite strongly against a binding contract. I consider that the better view is that there was not to be a binding contract until the conclusion of ongoing negotiations, including taking into account the trial period results, and execution of a formal contract."

Comments

This case demonstrates that a court need not be constrained by the *Masters v Cameron* analysis, whether with respect to three categories or four.

Indeed as Bret Walker SC (who was counsel for Mayne) has said in a paper earlier this year:[71]

> *"In conclusion, there is the possibility that Australian contract lawyers have been beguiled by yet another numinously enumerated Dixonian categorical analysis. (Four has less cultural resonance than three, maybe.) More seriously, the human urge to taxonomise any subject of interest can be taken too far, especially when the topic addresses the infinite variety of human interactions reported at one remove. The metaphor of a continuum used in Peden & Ors seeks to correct the excesses of that urge.*
>
> *There is much to be said for dispensing with all Masters v Cameron classes, to the same effect as the gentler suggestion in McLauchlan for two classes. Why not simply ask the question whether the objective intention of the putative parties, revealed in the permitted way, shows an intention to be bound? Questions of incompleteness of negotiation are necessarily and importantly subsumed in that factual inquiry. This entirely fits the approach taken in the classical exposition of the matter by Gleeson CJ in Australian Broadcasting Commission v XIVth Commonwealth Games (Hope and Mahoney JJA concurring):*
>
> > *. . . The problem which arises is that [the parties] have exchanged communications which, on the one hand, use the language of agreement but, on the other hand, disclose an expectation that at some future time a document embodying the terms of their contractual arrangement will be brought into existence. Where . . . the communications which the parties have exchanged are in writing, the question of their 'intention' is, prima facie, to be resolved objectively, and as a matter of construction of the relevant documents. Thus, in . . . Masters v Cameron . . . the majority [sic] in the High Court said ((1954) 91 CLR 353 at 362): 'The question depends upon the intention disclosed by the language the parties have employed, and no special form of words is essential to be used in order that there shall be no contract binding upon the parties before the execution of their agreement in its ultimate shape'."* (citation omitted)

5. Contract interpretation and the resolution of ambiguity by reference to extrinsic evidence

The principles governing the entire field of contractual interpretation are very extensive and beyond the scope of this presentation.[72]

We will concern ourselves only with the resolution of ambiguity by reference to extrinsic evidence.

5.1 Parol Evidence Rule

Mason J summarised the parol evidence rule in *Codelfa Construction Pty Ltd v State Rail Authority of NSW*[73] in the following terms:

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[71] B Walker, "The Fourth Category of Masters v Cameron" (2009) 25 Journal of Contract Law 108 at 116-7.

[72] Some notable texts and articles are suggested: Sir Kim Lewison, *The Interpretation of Contracts* (2007, 4th edn); Gerard McMeel, *The Construction of Contracts: Interpretation, Implication and Rectification* (2007); Catherine Mitchell, *Interpretation of Contracts* (2007).; D W McLauchlan, "Contract formation, contract interpretation and subsequent conduct" (2006) 25(1) *University of Queensland Law Journal* 78; and J.W. Carter, "Commercial Construction and Contract Doctrine" (2009) 25 *Journal of Contract Law* 83; and D W McLauchlan, "Contract Interpretation: What is it about?" (2009) 31(5) *Sydney Law Review* 5.

> *"The broad purpose of the parol evidence rule is to exclude extrinsic evidence (except as to surrounding circumstances), including direct statements of intention (except in cases of latent ambiguity) and antecedent negotiations, to subtract from, add to, vary or contradict the language of a written instrument (*Goss v Lord Nugent *(1833) 5 B & Ad 58 at 64–5; 110 ER 713 at 716). Although the traditional expositions of the rule did not in terms deny resort to extrinsic evidence for the purpose of interpreting the written instrument, it has often been regarded as prohibiting the use of extrinsic evidence for this purpose. No doubt this was due to the theory which came to prevail in English legal thinking in the first half of this century that the words of a contract are ordinarily to be given their plain and ordinary meaning. Recourse to extrinsic evidence is then superfluous. At best it confirms what has been definitely established by other means; at worst it tends ineffectively to modify what has been so established."*

The result of the parol evidence rule is that, subject to exceptions, where the parties have recorded their contract in writing, extrinsic evidence will not be admissible:

- to subtract from, add to, vary or contradict the written terms; or
- for the purpose of interpreting the written terms.

We are here concerned with the second of those; that is the interpretation of the written terms of a contract by reference to extrinsic evidence.

It follows that we will need to identify the exceptions to the parol evidence rule which allow for recourse to be had to extrinsic evidence to interpret the written terms of a contract.

The recognised exceptions to the parol evidence rule include the following:

- where there are some terms of the contract in writing and some not;[74]
- where a collateral contract is alleged;[75]
- where there is a plea of rectification;[76]
- where a condition precedent is alleged;[77]
- where a variation to the contract is alleged; and
- where regard is sought to be had to extrinsic evidence as an aid in the interpretation of the written terms.

It is the last of these exceptions to the parol evidence rule in which we are presently interested.

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[73] (1982) 149 CLR 337 at 347.

[74] *Hoyts Pty Ltd v Spencer* (1919) 27 CLR 133 at 143.

[75] *L G Thorne & Co Pty Ltd v Thomas Borthwick & Sons (Australasia) Ltd* (1955) 56 SR (NSW) 81.

[76] *B & B Constructions (Aust) Pty Ltd v Brian A Cheeseman & Associates Pty Ltd* (1994) 25 NSWLR 227.

[77] *Kirwin v Pearson* (1882) 3 LR (NSW) 162.

5.2 Extrinsic Evidence

The oft-cited and classic definition of this exception to the parol evidence rule is that of Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of NSW:*[78]

> *"The true rule is 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. But it is not admissible to contradict the language of the contract when it has a plain meaning. Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious knowledge of them will be presumed.*
>
> *It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable. The point is that such statements and actions reveal the terms of the contract which the parties intended or hoped to make. They are superseded by, and merged in, the contract itself. The object of the parol evidence rule is to exclude them, the prior oral agreement of the parties being inadmissible in aid of construction, though admissible in an action for rectification.*
>
> *Consequently when the issue is which of two or more possible meanings is to be given to a contractual provision we look, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties' presumed intention in this setting. We do not take into account the actual intentions of the parties and for the very good reason that an investigation of those matters would not only be time consuming but it would also be unrewarding as it would tend to give too much weight to these factors at the expense of the actual language of the written contract."* [emphasis added]

The result is that, as formulated by Mason J in *Codelfa*, extrinsic evidence was admissible as an aid in the interpretation of written terms where:

- the written terms were ambiguous; and
- the evidence sought to be adduced was of the objective background.

5.3 Ambiguity

However, since the High Court decisions of *Pacific Carriers Limited v BNP Paribas*[79] and *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd,*[80] it is more or less resolved that ambiguity is no longer a requirement for the admission of objective evidence to aid in the interpretation of written terms.

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[78] (1982) 149 CLR 337 at 352.

[79] [2004] HCA 35.

[80] [2004] HCA 52.

In *Lion Nathan Australia Pty Ltd v Coopers Brewery Ltd*,[81] the Full Federal Court observed:

> *" [46] I am also satisfied that the controversy engendered by the passage from the judgment of Mason J in Codelfa, to which to which Finn J referred, has now been largely resolved by recent High Court cases dealing with the use of surrounding circumstances when construing contracts. I refer, in particular, to Pacific Carriers, Equuscorp Pty Ltd v Glengallan Investments Pty Ltd (2004) 218 CLR 471 ; 211 ALR 101 ; [2004] HCA 55, and Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd (2004) 219 CLR 165 ; 211 ALR 342 ; [2004] HCA 52 (Toll). In effect the High Court has determined that, at least when construing commercial contracts, the "surrounding circumstances" or "factual matrix" may be taken into account. This is so in all cases, even if the words at issue are not ambiguous, or susceptible of more than one meaning.*
>
> *…*
>
> *[100] It is also clear from Pacific Carriers and Toll that, generally speaking, it is permissible to have regard to the surrounding circumstances from the outset of the process of construction. The view that once had some currency — that one must first find some ambiguity in the text of the document before looking to extrinsic circumstances — no longer holds sway.*
>
> *…*
>
> *[238] The need for an ambiguity before recourse can be had to previous negotiations is no longer the law…"*

Recently, in the decision of *GMA Garnet Pty Ltd v Barton International Inc*,[82] the Federal Court further confirmed this development in the law and conveniently summarised the current approach:

> *"[93] In relation to the "objective framework of facts within which the contract came into existence", as Mason J put it in Codelfa 149 CLR 337, it is commonly understood that the proper construction of a contract should reflect what reasonable people in the position of the contracting parties would have understood by the relevant clauses, considering not only their text, but also the surrounding circumstances and the purpose and object of the entire transaction and its elements: Pacific Carriers Ltd v BNP Paribas (2004) 218 CLR 451 at 461–462 [22]; Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd (2004) 219 CLR 165 at 179 [40]; International Air Transport Assn v Ansett Australia Holdings Ltd (2008) 234 CLR 151, [8], [53].*
>
> *[94] In International Air Transport Assn 234 CLR 151 at [53], in the joint judgment of Gleeson CJ, Gummow, Kirby, Hayne, Heydon, Crennan and Kiefel JJ, their Honours confirmed that the task of construction is to be approached in the manner described as follows by Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ in Toll 219 CLR 165 at [40]:*
>
> > *This Court, in Pacific Carriers Ltd v BNP Paribas (footnote omitted), has recently reaffirmed the principle of objectivity by which the rights and liabilities of the parties to a contract are determined. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that*

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[81] [2006] FCAFC 144.

[82] [2009] FCA 439.

> *govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe. References to the common intention of the parties to a contract are to be understood as referring to what a reasonable person would understand by the language in which the parties have expressed their agreement. The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction (footnote omitted).*
>
> *[95] It may be said that it is now generally accepted in Australia, particularly having regard to this recent dicta of the High Court of Australia which makes no mention of an ambiguity factor as a precondition to considering other factors, that there is no need for ambiguity to be demonstrated in a contractual provision before regard can be had to the surrounding circumstances known to the parties and the purpose and object of the transaction. See also Seddon NC and Ellinghaus MP, Cheshire and Fifoot's Law of Contract (9th Australian ed, Lexis Nexis Butterworths, 2008) at [10.12], and authorities there referred to."*

5.4 Objectivity

In *Codelfa Construction Pty Ltd v State Rail Authority of NSW,*[83] Mason J stated:

> *"The concept of `surrounding circumstances' is to be understood to be a reference to `the objective framework of facts'. It will include evidence of prior negotiations so far as they tend to establish objective background facts known to both parties and the subject matter of the contract. It will also include facts so notorious that knowledge of them is to be presumed. Additionally it will include evidence of a matter in common contemplation and constituting a common assumption. From the evidence of that setting the parties' presumed intention may be taken into account in determining which of two or more possible meanings is to be given to a contractual provision. What cannot be taken into account is evidence of statements and actions of the parties which are reflective of their actual intentions and expectations. Objective background facts can include statements and actions of the parties which reflect their mutual actual intentions. That is, evidence of the mutual subjective intention of the parties to a contract may be part of the objective framework of facts within which the contract came into existence. It is the mutuality which makes the evidence admissible."*

The Federal Court has recently observed in *Colby Corporation Pty Ltd v Commissioner of Taxation:*[84]

> *"[49] The need to consider the objective rather than subjective intention of the parties has been confirmed by the High Court in Pacific Carriers Ltd v BNP Paribas (2004) 218 CLR 451 at 461–2 ; 208 ALR 213 at 220–2 ; [2004] HCA 35 and in Toll. The High Court's affirmation of the principle in the unanimous judgments in both these cases put the matter beyond doubt. In the latter case the High Court said (at CLR 179; ALR 351–2):*
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> > *This Court, in Pacific Carriers Ltd v BNP Paribas has recently reaffirmed the principle of objectivity by which the rights and liabilities of the parties to a*

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[83] (1982) 149 CLR 337 at 352.

[84] [2008] FCAFC 10 at [49].

> *contract are determined. It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe. References to the common intention of the parties to a contract are to be understood as referring to what a reasonable person would understand by the language in which the parties have expressed their agreement. The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That normally requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction."*

As to the distinction between objective and subjective intention, the High Court said in *Pacific Carriers Ltd v BNP Paribas*:[85]

> *"What is important is not Ms Dhiri's subjective intention, or even what she might have conveyed, or attempted to convey, to NEAT about her understanding of what she was doing. The letters of indemnity were, and were intended by NEAT and BNP to be, furnished to Pacific. Pacific did not know what was going on in Ms Dhiri's mind, or what she might have communicated to NEAT as to her understanding or intention. The case provides a good example of the reason why the meaning of commercial documents is determined objectively: it was only the documents that spoke to Pacific."*

5.5 Subsequent Conduct

We have seen already that courts will have regard to the subsequent conduct of parties to determine whether an agreement may have been concluded (see paragraph 3.3 above).

However, evidence of parties' subsequent conduct cannot be used to sweep away the ambiguities of a contractual term.[86]

This rule is widely and strongly supported by case law and leading commentaries. The policies and principles underlying this rule are numerous and include:[87]

- The understanding that courts can only look to the "objective framework of facts within which the contract came into existence, and to the parties' presumed intentions in this setting."[88]
- Subsequent conduct must be excluded otherwise "one might have the result that a contract meant one thing the day it was signed, but by reason of subsequent events meant something different a month or a year later."[89]

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[85] (2004) 218 CLR 451.

[86] *Brambles Holdings Pty Ltd v Bathurst City Council* (2001) 53 NSWLR 153 at [25]-[26].

[87] D W McLauchlan, "Contract formation, contract interpretation and subsequent conduct" (2006) 25(1) *University of Queensland Law Journal* 78 at 98-106.

[88] *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 352.

[89] *Sportsvision Australia Ply Ltd v Tal/glen Pty Ltd* (1998) 44 NSWLR 103 at 114.

- Allowing subsequent conduct evidence "would be uncertain in its operation and mischievous in its effect."[90]

- Permitting evidence of subsequent conduct would create uncertainty and inefficiency.[91]

However, Professor McLauchlan has opined that the distinction between the two principles is fine – perhaps so fine that it is untenable:[92]

> *"What is the basis for treating evidence of the parties' subsequent conduct as admissible when the issue before the court is one of contract formation but inadmissible when the issue is one of contract interpretation? If the fundamental question of whether a contractual relationship exists at all can be determined by having regard to the parties' conduct subsequent to the alleged point of formation, surely the position should be no different when the perhaps subsidiary questions of interpretation are involved. In both contexts the essential task of the court is to determine and give effect to the intention of the parties. And just as, for example, the parties' conduct may tend to confirm (or deny) that an earlier agreement was intended to be binding, so also it may tend to confirm (or deny) that the parties gave a particular meaning to the terms of an admitted contract at the time it was entered into …."*

Lord Steyn has also noted that:[93]

> *"Business people and, for that matter, ordinary people, simply do not understand a rule which excludes from consideration how the parties have in the course of performance interpreted their contract. The law must not be allowed to drift too far from the intuitive reactions of justice of men and women of good sense: the rule about subsequent conduct may have to be re-examined."*

Additionally, in *Agricultural and Rural Finance Pty Ltd v Gardiner,*[94] Kirby J (dissenting judgment) said:

> *"… I would not accept this conclusion as stating an absolute rule. I do not agree that later communications and conduct of parties to an agreement are inadmissible when tendered to indicate acceptance by the parties of a particular meaning of the language used in their agreement. For example, if an agreement included technical words, the communications and conduct of the parties after the execution of that agreement might be admitted to throw light on a common understanding as to the meaning of such words. In particular circumstances, the common understanding of the language of a written agreement might assist in deriving the objective meaning of the text."* [citations omitted]

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[90] *FAI Traders Insurance Co Ltd v Savoy Plaza Pty Ltd [*1993] 2 VR 343 at 350-351.

[91] *Sportsvision Australia Pty Ltd v Tal/glen Pty Ltd* (1998) 44 NSWLR 103 at 116.

[92] D W McLauchlan, "Contract formation, contract interpretation and subsequent conduct" (2006) 25(1) *University of Queensland Law Journal* 78.

[93] Johan Steyn, 'The Intractable Problem of the Interpretation of Legal Texts' (2003) 25 Sydney Law Review 5 at 10; also see G McMeel, “Prior Negotiations and Subsequent Conduct — the Next Step Forward for Contractual Interpretation?” (2003) 119 LQR 272.

[94] (2008) 251 ALR 322

Further, the New Zealand Supreme Court in the decision of *Wholesale Distributors Ltd v Gibbons Holdings Ltd*[95] has refused to exclude post-contractual conduct.

Earlier this year, the Full Court of the Supreme Court of South Australia observed a lack of clarity with respect to the position[96] and Gray J observed:

> *"[17] In Wholesale Distributors Ltd v Gibbons Holdings Ltd, the New Zealand Supreme Court refused to apply the English exclusionary rule which provides that such evidence is inadmissible. Thomas J, who delivered the leading judgment of the Court, found that his interpretation of the original contractual document was confirmed by the terms of an assignment occurring some three years later. Although Thomas J was the only member of the court who expressly had regard to post-contractual matters, Elias CJ, Tipping and Anderson JJ all agreed with the general proposition that the parties' conduct post-contract was admissible and relevant to the construction of the contract.*
>
> *[18] In the course of his reasons, Tipping J highlighted the relevance of post-contract conduct in ascertaining the intentions of the parties as follows:*
>
> > *As a matter of principle, the court should not deprive itself of any material which may be helpful in ascertaining the parties' jointly intended meaning, unless there are sufficiently strong policy reasons for the court to limit itself in that way. I say that on the basis that any form of material extrinsic to the document should be admissible only if capable of shedding light on the meaning intended by both parties. Extrinsic material which bears only on the meaning intended or understood by one party should be excluded. The need for the extrinsic material to shed light on the shared intention of the parties applies to both pre-contract and post-contract evidence. Provided this point is kept firmly in mind, I consider the advantages of admitting evidence of post-contract conduct outweigh the disadvantages. … For good policy reasons the common law has consistently adhered to what is usually called an objective approach to contract interpretation. An objective inference from conduct in which the parties are mutually involved after they have contracted does not significantly depart from the conventional approach. I will call conduct in which both parties are involved, either actively or passively, mutual or shared conduct. Inviting inferences from the conduct of one party, in which the other party is not involved, would make a significant inroad into the need to ascertain objectively the shared intention of the parties as to their meaning. The words they have used, construed in the light of all the relevant and objective circumstances in which the parties have used them, must prima facie be the best guide to their meaning. But, if some mutual or shared post-contract conduct of the parties is objectively capable of shedding light on the meaning they themselves placed on the words in dispute, I consider more is to be gained than lost by allowing the court to take it into account. In this manner, in New Zealand, post-contract conduct is an aspect of the relevant surrounding circumstances to be considered in resolving ambiguities in contractual documents.*
>
> *[19] Although the Australian Courts have generally applied the English exclusionary rule, the relevance of post-contract conduct in Australia is unclear. The Australian approach to post-contract conduct is not necessarily in conflict with the New Zealand approach, as the concept of surrounding circumstances does not*

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[95] [2008] 1 NZLR 277.

[96] *Symbion Medical Centre Operations Pty Ltd v Thomco (No 2113) Pty Ltd* [2009] SASC 65

exclude the proposition that those circumstances may both precede and post-date the contract. The recognition of this appears implicit in the recent New South Wales Court of Appeal decision of Sagacious Procurement Pty Ltd v Symbion Health Ltd, where the Court considered the use of subsequent communications in interpreting the earlier communications. Giles JA (with whom Hodgson and Campbell JA agreed) summarised as follows:

> *I respectfully suggest that subsequent communications are not simply aids to interpretation, or a source of information as to matters with which a concluded contract should deal. Their probative value may be more direct. To repeat, the objective intention of the parties is fact-based, and found in all the circumstances. That in their subsequent communications the parties have continued in negotiations, or have expressed the common understanding that they are not legally bound unless and until a formal contract is executed, is of itself probative as to their contractual intention: see Howard Smith and Co Ltd v Varawa, stating simply that any statements or conduct inconsistent with the existence of a concluded contract are relevant.*

[20] Extrinsic evidence may be admissible when a contract is partly written and partly oral. In these circumstances, " … the parties to the contract have not expressed all the terms of their contract in writing, and, accordingly, parol evidence is admitted to complete the written contract". Extrinsic evidence of the parties' intention may also be admissible for the purpose of rectifying a document so that it expresses that intention. The consideration of extrinsic evidence in these circumstances does not import additional or different terms into the contract, but reforms the instrument so that it accords with what the parties actually agreed to. Similarly, extrinsic evidence can be used to resolve ambiguity in contracts, although, as observed earlier, this admissible evidence generally excludes subsequent conduct.

[21] As a consequence of the many exceptions to the parol evidence rule, the scope of the rule in Australia is difficult to define with any certainty. The English exclusionary rule is the subject of a number of exceptions. The New Zealand approach to post-contract conduct creates further doubt as to the confines of the exclusionary rule."

However, *Masterton Homes Pty Ltd v Palm Assets Pty Ltd*[97] appears to reinforce the rule that subsequent conduct cannot be used to aid interpretation of contracts:

"[114] The second matter that I mention, without deciding, is that there is English authority that the rule whereby subsequent conduct cannot be used as an aid to construction of a contract does not apply to a contract that is partly written and partly oral … In County Securities v Challenger Group Holdings at [18]–[28] Spigelman CJ accepted that subsequent conduct could be an aid to identification of the subject matter of a contract, and identification of "necessary terms which were not the subject of express provision in a contract not reduced to writing". … There is also some authority that subsequent conduct can be looked at to identify the terms of a contract not wholly in writing in Winks v WH Heck & Sons Pty Ltd [1986] 1 Qd R 226 at 238 per Thomas J, and in Sydney Hawthorne and Plastec Australia Pty Ltd v Harris [1995] FCA 1094 at [10] (sub nom Re Combined Security Systems & Designs Pty Ltd (unreported, Federal Court of Australia, Drummond J, 28 February 1995) at 6). Though the Australian position is not yet completely settled, there is a significant body of Australian authority, some of which is collected in Pethybridge v Stedikas

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[97] [2009] NSWCA 234 at [114]; also see *Nicolazzo v Harb* [2009] VSCA 79.

Holdings Pty Ltd [2007] NSWCA 154; [2007] Aust Contract Reports 90-263 (90,058) at [59], and including authority in this Court, in favour of the view that subsequent conduct cannot be looked at as an aid to construction of a contract. The cases that favour the more restrictive view of the availability of subsequent conduct as an aid to construction would need to be looked at to decide whether the statements of principle in them were made in a context where it was a contract wholly in writing that was being considered. As well, there is (to put it neutrally) room for debate about whether it is appropriate ever to talk about "construction" of a contract not wholly in writing. …"

6. Conclusions

We have seen that, as technology advances, the way that business is done evolves to take advantage of the new developments.

In many instances, traditional contractual analysis will remain relevant, for example with respect to offer and acceptance over the internet.

However, the real challenge has always been that all too often, the imperfect dealings of business people simply do not lend themselves to too rigid an analysis.

The courts are showing increasing flexibility with respect to their analysis of contract formation and interpretation, in particular as regards what might be legitimately taken into account, including the subsequent conduct of the parties, subject always to some key provisos, including particularly that:

- the exercise must remain an objective one; and
- written terms will tend to have priority over conduct.

Some of the more rigid models look to be at risk of being left behind as a result, for example the classic categorisations under *Masters v Cameron*. The prevailing approach seems to be one of flexibility rather than rules and exceptions.

Perhaps one of the more frank and realistic assessments is that of Cooke J in *Meates v Attorney-General* [1983] NZLR 308 at 377:

> *"… The acid test in the case like the present 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."*

The main difficulty that results is that it may seem to become increasingly difficult to predict what will be the conclusion reached by a particular court on particular facts.

However, perhaps it was always thus, and the more rigid approaches of the past satisfied a human need but ultimately were also thwarted by the imperfections of the real dealings between people.

As practitioners, the challenge for us remains to build our armoury of analytical tools and techniques and practice applying them flexibly so that we are adept at both:

- advising our clients; and
- persuading our colleagues and the courts of our client's cause –

on any particular facts.

In practice, these skills will be most important in advising clients regarding the entry into letters of intent and like arrangements, and in later advising them in the event of a dispute.

The fundamental question for any such client is whether or not they wish to be bound?

If they do, they should say so unambiguously in the letter of intent and they should include the most detailed terms possible in the circumstances. They must understand that they must be prepared to be bound on those very terms for the duration of the project or transaction.

Having identified the most detailed terms possible in the circumstances, the client should consider again whether or not they wish to be bound for the duration.

If they do not wish to be bound then that is what they should say in the letter of intent. They will also need to address the rights of the parties in respect of such performance as there may be of the project or transaction during any period before it is ultimately agreed to be abandoned. Should there be a lesser contract for that purpose? How might it be terminated and what would result?

Of course these decisions are typically required to be made urgently due to commercial imperatives.

In my practice as a construction lawyer, the critical elements of letters of intent tend to be:

- the terms and conditions that will govern the project, typically a standard form building contract, either:
  - » unamended; or
  - » if our client has sufficient sway, customised with our suite of special conditions and amendments to best protect our client's interests;
- the consideration, being:
  - » a fixed lump sum to be adjusted and paid according to the terms and conditions of the building contract; or
  - » occasionally, a formula to determine what should be paid, ideally by reference to rates, the more detailed the better, to be applied by a competent third party; and in either case
  - » a procedure to deal with payment, often as a proportion of the whole, for any works performed if the project does not ultimately proceed;
- the scope of works, which might range from:
  - » a very detailed design under a traditional construct-only building contract; to
  - » a performance based specification under a design and construct building contract;
- the time for performance, ideally by reference to a date to be adjusted, and with liquidated damages to be paid, according to the terms and conditions of the building contract; and
- termination rights and consequences.

If your client receives such a letter and does not wish to be bound then they must say so. Similarly, they should say so if they have a position with respect to any of the terms proposed.

Finally, if they are unable to achieve such a level of precision in the circumstances, or if their commercial assessment is that it is appropriate to do so, of course clients remain free to take their chances on a deliberate journey through these uncharted waters, perhaps by trying to follow the silvery trail of equity, but always at the risk of becoming a case study for a presentation like this.