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What Are Your Intentions? Drafting and Negotiating Letters of Intent

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Your purchaser client has been introduced to a seemingly perfect property and wants to put in an offer to purchase and then start planning its financing or entice joint venture partners. To show the potential vendor that the potential purchaser is committed, a real estate agent puts together a letter of intent ("**LOI**"). That LOI includes language stating that the property is being sold on an as-is basis, and contemplates a short due diligence period, both of which should sound great to the potential vendor. The LOI also clearly states that it is non-binding, and further provides that the lawyers acting for the vendor and the purchaser will proceed to prepare and negotiate a formal purchase agreement within five business days. It's a familiar story. Approach with caution!

LOIs (and similar preliminary agreements called by any other name such as memorandums of understanding or term sheets) can be great tools when used carefully. They can be efficient, cost effective ways for parties to set out agreed-upon terms, sometimes without involving lawyers. They can establish a level of trust between the parties and help move a deal forward. The most important terms come to light early, and deal breakers are identified. A lawyer can then use the LOI to draft the purchase agreement with clear instructions on the terms and conditions that the parties have agreed to.

Moving beyond the routine familiarity of an LOI, consider what a court would think of your LOI. If you end up in front of a judge, will it be interpreted as an agreement to agree, which is unenforceable, or will it be interpreted as an enforceable contract for the purchase and sale of land, which satisfies or falls outside the Statute of Frauds for some reason?

Courts have looked beyond attempts to create a non-binding LOI and have held parties accountable to provisions that in the early stages of a deal perhaps were not meant to be enforceable, but language or actions of the parties result in provisions

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being enforced against a party. Based on the language contained therein, or the subsequent conduct of a party, the effect of a "non-binding" LOI can change.

What Did You Say?

WHAT DID YOU SAY: AGREEMENTS TO AGREE

Provisions in your non-binding LOI could end up binding on the parties, depending on the language you have used in your LOI. Did you say this LOI was actually an "agreement", or did you "agree" to something rather than "intend" it? Did you include all of the essential terms of the transaction? Did you forget to include any conditions that you need to satisfy first? All of the foregoing can make the LOI binding, even if that was not your intention.

In purporting to enter into a non-binding LOI, the parties often hope, for legal purposes, that they are creating an agreement to agree. Agreements to agree are generally unenforceable. What have the courts decided goes beyond an agreement to agree to constitute a complete and enforceable agreement?

The courts will first look to the intentions of the parties to determine whether they intended to be bound by the terms of the LOI. To determine the intent, the courts will review the language contained within the LOI. Where the language reveals an intention that the LOI, or certain provisions within the LOI are stated to be binding, this will be clear evidence of an intention to be bound. Secondly, the courts will determine whether the LOI contains all of the essential terms of the overall agreement. The essential terms are deal-specific and will be looked at on a case-by-case basis.

Canada Square Corp. v. Versafood Services Ltd.

In this case involving a brief letter prepared by a senior officer of a landlord, which letter was accepted by a senior officer of a tenant, the court filled in a more specific description of the premises, the commencement date and the rental payment schedule as part of an interpretation of the letter as the complete agreement between the parties. There was no clear reference within the letter for the need for any further documentation (i.e. a lease or an offer to lease). The parties that put the letter together were sophisticated businessmen who had authority to bind each corporation, and the parties subsequently went on to act as it they were contractually bound. The brief letter was therefore held to be enforceable.

The Language Indicates an Enforceable Preliminary Agreement

In the Ontario Court of Appeal case *Canada Square Corp. et al. v. Versafood Services Ltd.*[2] a simple, thirteen point letter was held to be enforceable against a tenant attempting to escape a lease arrangement. There was no reference within the letter to any further, formal agreement. While there was a condition contained within the letter requiring the landlord's lender's approval, the letter interestingly concluded with the statement "[t]his constitutes the general principles of

[2] (1982), 34 O.R. (2d) 250 (C.A.) [*Canada Square*].

our agreement with you."[3] The court interpreted the letter being enforceable as it contained all of the essential elements of a lease and set out the agreement between the parties without uncertainty.

The Preliminary Agreement Contains all Essential Terms

In determining whether a preliminary agreement contains all of the essential terms, a court will look at what the parties consider essential, which is determined on a case by case basis. For example, in *Hunter v. Baluke*,[4] the parties and their real estate agents prepared an offer and counter-offers in respect of the purchase and sale of a Muskoka area cottage. However, the parties did not come to a final agreement as to whether the vendor would be entitled to store its chattels and occupy the boat house and for a period following closing. The court held that the issue of possession of the boat house was an essential, material term to both parties, and without consensus on this matter, the agreement was be inadequate.

The Preliminary Agreement Contains a Condition

In *Wilson v. BKK Enterprises Inc.*[5] a confirming e-mail between lawyers which followed a telephone call regarding a settlement agreement was analyzed to determine whether the contents of the e-mail exchange constituted a binding agreement. The e-mail stated that the parties appeared to have "an agreement in principle". However, the e-mail also indicated that prior to finalizing the settlement agreement, the consent of a lender to add a second mortgage on title to a property would be sought. The court held that the e-mails were not an enforceable settlement agreement as it was clear that the lender's consent was a condition precedent to the agreement, which could not be waived. After it became clear that the lender's consent would not be forthcoming, the lawyers prepared further pleadings. This further act was more evidence that the parties did not intend the e-mail agreement to be binding; rather, it was a framework only.

Hunter v. Baluke

This case involved an attempted purchase by Wayne Gretzky and Janet Jones Gretzky of a cottage property on Lake Joseph in Muskoka. The property contained a main cottage and a guest cabin, together with a fully furnished boat house. The top floor of the boat house was occupied by the defendant vendor's parents from spring to fall. The lower floor of the boat house contained two boats and related chattels. The purchasers waived their inspection condition and delivered a deposit (albeit late). The vendor's agent advised in the later stages of negotiations that he did not "anticipate a problem" with the boat house issue.

The vendor then stated that the deal was off because the vendor did not want to disturb his parents with a winter move out of the boat house. The court held that a determination as to when vacant possession of the boat house was to be delivered was never truly settled. Further, the court held that the purchase agreement was never accepted, as based on the language contained in the standard OREA form, it was required to be accepted in writing, so any oral agreement in respect of the boathouse was not enforceable.

Preliminary Agreement Contemplates a Further ement

Within an LOI, language is often included whereby the parties agree to enter into a future "formal" purchase agreement. This language could be viewed as evidence that the parties

[3] *Ibid.* at page 9.

[4] (1998), 42 O.R. (3d) 553 (Gen. Div.) [*Hunter*].

[5] [2015] O.J. No. 3918 (S.C.J) [*Wilson*].

did not intend to be bound by the LOI. However, there have been cases where the contemplation of a further "formal" agreement is not enough to prove non-binding intent, such as was the case in *Calvan Consolidated Oil & Gas v. Manning*[6], wherein the court held that the parties intended to be bound by a preliminary agreement. The court pointed to an arbitration clause within the LOI, and stated that "the parties were bound immediately on the execution of the informal agreement, that the acceptance was unconditional, and that all that was necessary to be done by the parties or possibly by the arbitrator was to embody the precise terms, and no more, of the informal agreement in a formal agreement."[7]

Another question a court will look at when interpreting language requiring a further agreement is whether a future agreement was intended to be simply a further formality that would enhance the preliminary agreement, or whether the future agreement was intended to be the only agreement between the parties. The two basic principles with respect to whether a binding agreement was created in a preliminary agreement where a further contract is completed are set out in *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.*[8]:

> *"When they agree on all of the essential provisions to be incorporated in a formal document with the intention that their agreement shall thereupon become binding, they will have fulfilled all the requisites for the formation of a contract. The fact that a formal written document to the same effect is to be thereafter prepared and signed does not alter the binding validity of the original contract."*[9]

In other words, an LOI containing all of the essential terms of an agreement and showing an intent to be bound will be sufficient for a court to determine that a further, future agreement was a mere aspiration of the parties, not a condition.

In summary, agreements to agree will be held unenforceable where firstly, the essential terms are not agreed upon. Secondly, an agreement to agree may be held unenforceable where a further contract is specifically contemplated within the preliminary agreement. However, the courts will then determine whether the contemplation of a further contract is akin to an aspiration or a mere formality, or whether the contemplation of a further contract is a condition precedent of the bargain. If it is just a desire, then the agreement to agree is enforceable. If it is a condition precedent, then it the preliminary agreement is not enforceable because a condition must be fulfilled or satisfied. However, as was the case in *Calvan Consolidated Oil & Gas v. Manning*, this type of condition can be waived explicitly or implicitly through subsequent actions of the parties.[10]

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[6] [1959] S.C.R. 253 [*Calvan*].

[7] *Ibid.* at 261 citing *Hatzfeldt-Wildenburg v. Alexander*, [1912] 1 Ch. 284 at 288-9, 81 L.J. Ch. 184.

[8] 1991 CanLII 2734(ON CA).

[9] *Ibid.* at p12. See also *United Trust Co. v. Dominion Stores Ltd.,* [1977] 2 S.C.R. 915 (S.C.C.), *Hunter*, supra note 4, *Fairport Construction Ltd. v. Fraser Valley Credit Union, infra, note 23.*

[10] Lem, Bocska. *Halsbury's Laws of Canada: Real Property. Background of the principle that an "agreement to agree" is unenforceable* (Markham: LexisNexis Canada Inc., 2012), at HRP-167. See also *May & Butcher Ltd. v. R.*, [1934] 2 K.B. 17(H.L.) [*May*].

***Statute of Frauds*, R.S.O. 1990, c. S.19**

Writing required to create certain estates or interests

1. (1) Every estate or interest of freehold and every uncertain interest of, in, to or out of any messuages, lands, tenements or hereditaments shall be made or created by a writing signed by the parties making or creating the same, or their agents thereunto lawfully authorized in writing, and, if not so made or created, has the force and effect of an estate at will only, and shall not be deemed or taken to have any other or greater force or effect.

Leases to be made by deed

(2) All leases and terms of years of any messuages, lands, tenements or hereditaments are void unless made by deed.

How leases or estates of freehold, etc., to be granted or surrendered

2. Subject to section 9 of the Conveyancing and Law of Property Act, no lease, estate or interest, either of freehold or term of years, or any uncertain interest of, in, to or out of any messuages, lands, tenements or hereditaments shall be assigned, granted or surrendered unless it be by deed or note in writing signed by the party so assigning, granting, or surrendering the same, or the party's agent thereunto lawfully authorized by writing or by act or operation of law.

Except leases not exceeding three years, etc.

3. Sections 1 and 2 do not apply to a lease, or an agreement for a lease, not exceeding the term of three years from the making thereof, the rent upon which, reserved to the landlord during such term, amounts to at least two-thirds of the full improved value of the thing demised.

Writing required for certain contracts

4. No action shall be brought to charge any executor or administrator upon any special promise to answer damages out of the executor's or administrator's own estate, or to charge any person upon any special promise to answer for the debt, default or miscarriage of any other person, or to charge any person upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them, unless the agreement upon which the action is brought, or some memorandum or note thereof is in writing and signed by the party to be charged therewith or some person thereunto lawfully authorized by the party.

The parties may evidence an intention to be bound, paired with an oral agreement on all essential terms; however, an additional requirement in respect of agreements dealing with property to be tested is whether a preliminary agreement complies with or is otherwise excepted from the Statute of Frauds. Section 4 of the *Statute of Frauds*[11] provides that contracts for the sale of lands must be in writing to be enforceable, signed by the person in respect of which the contract is to be enforced against. Leases over three years must also be written and signed by the parties or their agents, or else the tenancy is merely an estate at will. There are certain exceptions to the Statute which are applicable in the context of LOIs.

Complete Contract

The courts have held that any piece of writing containing the essential terms of an agreement is sufficient to satisfy the Statute of Frauds,[12] and vague terms can be supplemented or clarified by parol evidence.[13] For example, in *Canada Square Corp. et al. v. Versafood Services Ltd.* the court determined that all essential terms were contained within a simple preliminary letter. Further, the senior officers that prepared and executed the preliminary agreement on behalf of the landlord and tenant were sophisticated business people that had the authority to bind their companies. A thirteen point letter was determined to bind the parties to a sophisticated lease arrangement.

As well, note that there is judicial support to join more than one writing together to constitute a complete contract.[14] In addition, a computer generated contract and a series of e-mails have been held as sufficient to satisfy the Statute of Frauds.[15] In *Barber v. Davidson*,[16] a series of exchanges of correspondence between solicitors for the purchaser and vendor constituted a

[11] R.S.O. 1990, c. S.19.

[12] S.M. Waddams, *The Law of Contracts*, 6th ed. (Aurora: Canda Law Book, 2010) at para 232.

[13] *Ibid.* at paragraph 233.

[14] *Bakken Estate v. Gibbons* (1980), 109 D.L.R. (3d) 559 (Alat C.A.).

[15] *Leoppky v. Meston,* [2008] 40 B.L.R. (4th) 69 (A.B.Q.B) [*Leoppky*].

[16] [1958] O.J. No. 365 (C.A.).

memorandum in writing that satisfied the Statute of Frauds and created a binding agreement because collectively, they had determined all essential terms of the agreement.

It becomes easy to see how an LOI could be interpreted by a court as enforceable in light of the foregoing familiar rules of contract law.

What Did You Do?

Even where the LOI is not in itself held to satisfy the Statute of Frauds, where the parties commence acting as if they are intending to be bound by the terms of the LOI, sometimes unexpected results can occur.

Wallace v. Allen

Graham Allen started discussing selling his business to his friend and neighbour, Kim Wallace. After several discussions, the parties put together and signed an LOI, setting out what they saw as all of the essential terms of the transaction. Their lawyers then set out to put together a share purchase agreement, and then prepared for closing. When it came time to close the deal, Allen, the seller, refused to close. The final share purchase agreement was never signed.

When Allen decided he did not want to close (due to property tax arrears and liability under a contract, which the court held was immaterial), he tried to rely on the non-binding language in the LOI to back out of the sale. However, in its analysis of the facts, the Court looked at not only the language of the LOI, but also the way that the parties approached the transaction. There were two draft letters of intent that were never signed, because the seller thought that "there remained too many things up in the air". Then, after that final LOI was signed, the parties appeared in all respects to be preparing for closing. Allen even announced his retirement and introduced Wallace as the new owner of the business. Wallace bought a house for his son in Orillia close to the business, the son left his job to work in the business. Despite the inclusion of non-binding language in the final, signed LOI, the Court of Appeal found that the LOI was, in fact, binding, primarily based on the actions of the parties, as well as the inclusion of certain language in the LOI that indicated that the LOI was, in fact, an "agreement".

The Ontario Court of Appeal in Ontario in *Wallace v. Allen*[17] looked at a letter of intent which had non-binding language in it and also contemplated a further purchase agreement. But, looking at the language, and more importantly, the subsequent conduct of the purchaser, the Court determined that the LOI was binding.

Part Performance/Quantum Meruit/Promissory Estoppel

Wallace v. Allen was recently applied in *Wilson v. BKK Enterprises Inc.*[18] and the court reiterated that the "conduct of the parties, after documentation is prepared, can be considered in determining whether the parties considered themselves bound".

The test to determine whether part performance is sufficient to take a contract dealing with land out of the Statute of Frauds was discussed in *Tavares v. Tavares.*[19] In this case, an unsigned lawyer's note which had named the owner incorrectly, contained no closing date, and was missing details of mortgage financing, which the Purchaser tried to rely on as the full agreement paired with a claim of part performance. No deposit was paid, however, the Purchaser hired an architect and started development work on the site. The court noted: "[t]he doctrine was designed to ensure that equity be done where the defendant has stood by and allowed the plaintiff, to his detriment, to fulfil his part of the oral contract, and where it would be unconscionable for the defendant to set up the Statute

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[17] (2009) 93 O.R. (3d) 723 (C.A.) [*Wallace*].

[18] [2015] O.J. No. 3918 (S.C.J.); at para 15. See also *1589380 Ontario Ltd. v. Heasty*, [2009] O.J. No. 2106 (S.C.J.).

[19] [2001] O.J. No. 2567 (S.C.J.), aff'd [2002] O.J. No. 241 (C.A.).

by asserting that the contract is unenforceable so that he might retain benefits which have accrued to him from the contract."[20]

Reliance on a note which was otherwise deficient for purposes of the Statute of Frauds, combined with an unconscionability analysis, could be enough satisfy the doctrine of part performance. But, note that in interpreting acts alleged to establish part performance, the courts have stated that the actions used to support the claim must be unequivocally referable to the alleged agreement.[21]

WHAT TO SAY AND DO: LESSONS LEARNED

DO SAY

There are phrases that have passed muster before the courts to ensure that a preliminary writing such as an LOI intended to be non-binding remains as such.

- As evidence that there was no binding contract, the Ontario Court of Appeal in *Bahamaconsult Ltd. v. Kelllogg Salada Canada Ltd.*[22] the following sentence was deemed to show that a further agreement was contemplated: "the following will confirm our various discussions to do with our <u>intention</u> to acquire…" Note that this language was paired with missing essential terms.

- In *Fairport Construction Ltd. v. Fraser Valley Credit Union,*[23] it was held that there was no binding agreement where a letter exchanged by the parties stated that their terms were "subject to further discussions and negotiations".

- In *Hunter v. Baluke,*[24] Section 6 of the OREA form of agreement of purchase and sale was used to defend an argument that an orally communicated counter-offer was binding on the parties. That Section, at the time of the judgment, stated: "Any notice relating hereto or provided for herein shall be in writing. This offer and any counter-offer notice of acceptance thereto shall be deemed given and received when hand-delivered to the address for service provided for in the acknowledgment below or where the facsimile number provided herein when transmitted electronically to that facsimile number."

- You may consider adding in a condition precedent within the LOI.[25] Specifically require a future agreement.

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[20] *Ibid.* at para. 3. Citing J.V. Di Castri, *The law of vendor and purchaser: the law and practice relating to contracts for sale of land in the common law provinces of Canada,* 2nd edition at p. 2, (Toronto: Carswell, 1976.)

[21] *Van. v. Qureshi*, [2013] O.J. No. 2536 (S.C.J.), aff'd by [2014] O.J. No. 1501 (C.A.). See *also Clark Machine Inc. v.* R. *Difruscia Holdings Ltd.*, [2010] O.J. No. 4416 (S.C.J.) [*Clark*].

[22] (1976), 15 O.R. (2d) 276 (C.A.).

[23] [1979] B.C.J. No. 1780 (B.C. Co. Ct.).

[24] *Hunter*, supra note 4 at para. 55.

[25] *Leoppky* , supra note 15.

- Make sure your LOI explicitly states that further essential terms still remain to be agreed upon between the parties before the arrangement is binding, and then make sure that all essential terms are not included or implied.

DON'T SAY

There are some phrases (or lack thereof) that have been interpreted by the courts as evidence that the parties intended to be bound by an LOI or preliminary agreement:

- Don't be silent on the condition of entering into a further, formal agreement, such as was the case in *Canada Square,* or any other important conditions. Moreover, the letter exchanged between the parties in *Canada Square* contained the words "the general principle of our agreement with you" which was evidence that the parties had intended to create a final and binding agreement.

- In *Wallace v. Allen*,[26] the LOI was peppered with the phrase "it is agreed", and contained the phrase "the wording of [the future agreement] may also vary somewhat". "It is agreed" was interpreted as creating a binding agreement. The phrase "the wording of [the future agreement] may also vary somewhat" evidences a desire to enter into a further agreement, but not a condition of a further agreement. Paired with the subsequent conduct of the parties clearly indicating part performance and an intention to be bound, the LOI was held binding.

- Never include an arbitration clause in a non-binding agreement, as this will be construed as handing over the power to fill in essential terms of an agreement to a third party, as was the case in *May & Butcher Ltd. v. R.*[27] *and Calvan Consolidated Oil & Gas Co. Ltd. v. Manning*.[28]

- In *Calvan Consolidated Oil & Gas Co. Ltd. v. Manning*,[29] the court pointed to the phrase "[t]his is to confirm our verbal understandings" as language evidencing an intent to be bound by those verbal understandings, and held that an LOI was therefore a binding agreement.

DO THIS

Advise your clients to be cautious about appearing to move forward with a deal, as subsequent conduct (by you or your client) can get your client in trouble. Do not accept agreements on behalf of your client without explicit instruction to do so.

- Prepare, negotiate and have the parties sign the further agreement, and ensure it contains language that extinguishes the LOI.

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[26] *Wallace*, supra note 17.

[27] *May*, supra note 10.

[28] *Calvan*, supra note 6.

[29] *Ibid.*

- As was the case in *Clark Machine Inc. v. R. Difruscia Holdings Ltd.*[30], follow up on the formal agreement and insist that it be completed. Document all relationships between the parties in writing to establish a usual practice to defend against oral agreements.

DON'T DO THIS

Wallace v. Allen is an instructive overview of what not to do if you do not want to be held to the terms of a non-binding LOI. More specifically, avoid taking your LOI out of the Statute of Frauds by ensuring that part performance cannot be alleged.

- Don't continue to negotiate terms after an expiry date of an LOI if you intend to extinguish the deal. In *Mason Homes Ltd. v. Oshawa Group Ltd.*,[31] the parties were held to have agreed upon the terms of a new arrangement after an expired deadline in a letter agreement through their subsequent discussions, leading the court to believe they still intended to work within the framework of the preliminary communication.

- Do not allow your client to act as if the LOI is binding in its subsequent conduct, and be clear in your communications with the other party and outsiders that the deal is not "firm" or "final".

- For a part performance claim to be successful, a party must show that it suffered a detriment. So do not as a vendor, allow a potential purchaser to spend money on extensive due diligence or give up other rights without reiterating that it is doing so without a final and binding agreement.

Non-Legal Strategic Impact

Even where the parties do not end up in front of a judge, what may start out as a friendly deal can turn sour where the terms of that LOI are not clear, or where things are later discovered about the property that you did not anticipate. As a purchaser, you are often at a disadvantage with respect to access to information about the property at the early stages of a transaction. Purchasers can limit their ability to negotiate a favourable deal depending on what they agree to include in an LOI, such as a comprehensive as-is clause. For example, your LOI said it was non-binding, but is the purchaser still obligated to accept that as-is clause in the purchase agreement? Does this preclude you from obtaining certain representations and warranties from a vendor?

As a vendor, you have the benefit of information about the property before you enter into an LOI. But, perhaps during negotiations a vendor uncovers information about the property that indicates it might have a higher value than it initially thought. Can the vendor go ahead and increase the purchase price? Even when the language of the LOI

[30] *Clark*, supra note 21.

[31] [2003] O.J. No. 3826 (S.C.J.) aff'd by [2005] O.J. No. 4344 (C.A.).

reads clearly that it is non-binding, the parties often feel that the LOI is morally binding.

In conclusion, an LOI can be a great tool to secure a deal. However, remind your clients to be sure that they can live with the terms contained in an LOI, because they may be stuck with them.