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Enforceability of letters of intent and memorandums of understanding

By Owen Bourns

Parties from time to time will enter into a letter of intent, memorandum of understanding or similar such preliminary agreements. Often they precede the execution of a more fulsome and detailed ultimate agreement. They range in content from vague agreements setting out conditions governing subsequent negotiations to more detailed documents setting out the terms the parties agree on to date and leaving open those parts left to be negotiated.

It is trite law that mere agreements to agree or agreements to negotiate are not enforceable because they lack certainty. With respect to more detailed letters of intent or memoranda of understanding the law is somewhat more convoluted in terms of determining whether some or all of the agreement can be enforced.

To form a binding agreement it is required that the “essential terms” be settled. Where the contract is too general or uncertain then it will not be valid.

In the recent case of *Georgian Windopwer Corp. v. Stelco. Inc.*, (2012) ONSC 3759 (Ont. S.C.J.) (“Stelco”) the parties entered into two preliminary agreements pertaining to the development of “industrial biotricity strategy” and to establish a land lease agreement for wind energy generation. The plaintiff brought an action for breach of the memorandum of understanding and the other preliminary agreement. Pattillo J. stated that, in certain circumstances, these types of preliminary agreements to agree can be binding:

> If the concept is sufficiently certain to enable agreement, the fact that the agreement provides for future mutual agreement does not result in it being too uncertain if there is a mechanism or formula set out. The issue is whether the provision for the future agreement is directory or mechanical as opposed to the substance of the provision.

In *Stelco* Pattillo J. held that the memorandum of understanding was generally unenforceable as it was an agreement to “confirm the general principles pertaining to the ongoing discussions between GWC and Stelco”. However, it was also determined that specific provisions in the memorandum of understanding were enforceable, including provisions binding the parties not to pursue “other interests”, not aligning themselves with competitors, restricting any public announcements, and requiring 60 days’ notice to terminate the memorandum of understanding. Stelco was found to have breached at least the notice provision.

Further, in *Darnley v. Tennant*, (2006) ABQB 575 (A.C.Q.B.) the letter of intent was found to be fully enforceable as it contained all the requirements of a binding contract,
including agreement on the essential terms. The owner of certain land signed a letter of intent permitting a neighbour to purchase a small access road for $1 in the event that a larger part of the parcel no longer required access via that access road and the subdivision approval was obtained. Slatter J. determined that the letter of intent was essentially a conditional agreement to sell the access road for $1 when the condition precedents were met. There was nothing that indicated the parties intended or were required to agree on other details in the future.

Some memoranda of understanding and letters of intent contain purported obligations to negotiate in good faith and/or to use best efforts to negotiate. In other circumstances, counsel have argued that these duties are implied as part of agreements to agree. However, the Stelco decision specifically explains that no such duties impliedly exist and where they are written into an agreement to agree they are unenforceable:

«...an agreement to negotiate in good faith is unenforceable. [...] the concept of a duty to carry on negotiations in good faith is repugnant to the adversarial position of the parties when involved in negotiations.»

Therefore, where a memorandum of understanding or letters of intent leave some of the essential terms of the agreement to be negotiated they will not be enforceable. However, the courts will enforce; (a) letters of intent and memoranda of understanding that contain all the requirements of binding contract including agreement on the essential terms, and (b) obligations in memoranda of understanding and letters of intent that are intended to bind the parties' behaviour during the period leading up to the execution of some ultimate agreement.

Owen Bourns is a lawyer in the firm's Litigation Law Group. He can be reached at 613.566.2823 or obourns@perlaw.ca. To view his bio, please click here.