

ARRANGEMENTS PRELIMINARY TO FORMAL CONTRACTS

By Horst K. Lucke*

A: INTRODUCTION

Pollock considered that informal contracting, typified by offer and acceptance, had to be distinguished from contracting in a set form (contracting in a "ceremonial" manner), for example, by signing a document or by exchanging signed engrossments¹. In both instances there must be not only agreement on terms, but also agreement to be bound by those terms². In informal contracting the very process of settling terms normally implies consent to be bound and, the moment the terms are settled, the consent to be bound usually takes effect. Where, however, the parties contemplate a mode of contracting which involves a ceremony of some kind, it is usually not the settlement of the terms, but the completion of the ceremony which manifests the parties' consent to be contractually bound, and it is only at that stage that a contract comes into existence. This distinction is neither new, nor confined to English law—it is set out quite clearly in *Justinian's Institutes*³. Informal contracting has become so frequent that at times lawyers lose sight of the importance of ceremonial contracting. Indeed, it is occasionally argued that such ceremonial observances, where still encountered, are mere meaningless formalities which do not delay the creation of the contract. In *Eccles v. Bryant and Pollock*⁴, for example, it was argued that a real estate transaction had become binding regardless of the completion of the exchange of documents which the parties contemplated. But Lord Greene M.R. dismissed this argument with some impatience:

"It was argued that exchange is a mere matter of machinery having in itself no particular importance and no particular significance. So far as significance is concerned, it appears to me that not only is it not right to say of exchange that it has no significance, but it is the crucial and vital fact which brings the contract into existence. As for importance, it is of the greatest importance, and that is why in past ages this procedure came to be recognized by everybody to be the proper procedure and was adopted . . . It is of the greatest importance that there should be no dispute whether a contract had or had not been made and that there should be no dispute as to the terms of it. This particular procedure of exchange ensures that none of those difficulties will arise"⁵.

* LL.B. (Adelaide), M.J.C. (New York), Dr.Jur. (Cologne), Reader in Law, University of Adelaide.

1. *Principles of Contract* (3rd ed., 1881) 4-6.
2. See observations by Higgins J. in *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.* (1908) 5 C.L.R. 647, at 650.
3. Book III, Title XXIII; Lee: *The Elements of Roman Law* (4th ed., 1956), 318.
4. [1948] 1 Ch. 93.
5. *Ibid.*, at 99 *et seq.*

It is typical of a transaction involving "ceremonial" consent that the parties come to complete agreement about all their terms prior to the actual making of the contract. The documents containing the agreed terms are usually drawn up well before the actual execution. The parties' mutual understanding about the terms of the proposed contract is, admittedly, an agreement in one sense of the term; it is, however, in no sense a contract unless and until the document is signed or otherwise executed and made binding in the agreed manner. Such an agreement is merely the basis of a future contract, if it should be concluded⁶, or, to use the distinction made by Higgins J. in *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.*⁷, they are agreements on terms without the additional agreement to be bound by them. At times, we find these agreements described as conditional contracts, the condition being the execution of the formal document⁸. "Conditional contract", however, more appropriately describes a *binding agreement* which cannot be repudiated, but which may, partly or wholly, remain inoperative unless specified conditions occur⁹. Therefore, in order to avoid confusion, we should not describe a mere agreement on terms, which is not binding in any respect, as a conditional contract.

The case which prompted Lord Greene's comments was a simple case of contracting by exchange of signed engrossments. Often, however, such cases are complicated by the existence of an intermediate document like a sale note or other memorandum in which the parties have laid down their provisional agreement concerning the projected transaction on the understanding that the final, formal version of the contract is to be drawn up by legal experts and executed later. The very existence of such intermediate documents shows that the parties have reached some finality in their negotiations about the terms, even though they may still want to take the precaution of getting a legal expert to scrutinize and, if necessary, improve the agreement. Although the lawyer may not suggest any changes of substance, he will ensure that the parties' main objectives are expressed with perfection, that provision is made for contingencies which carry the seeds of future dispute and litigation, that formal requirements are satisfied and that the statute and common law concerning voidness and illegality is not infringed. The question frequently arises whether the intermediate arrangement amounted to nothing more than an agreement on terms, that is, the basis for a possible future contract, or whether it had the full status of a binding contract. Harking back to Lord Greene's dictum about the significance and importance of formal contracting, we would doubtless be tempted to conclude that such preliminary arrangements are rarely, if ever, more than mere agreements on terms. As Fry J. stated: "Now if the matter were not covered by decision, it is very probable that I should feel myself drawn to the conclusion that wherever there is a reference to a future contract the letters themselves¹⁰ do not constitute a contract, and for this very obvious reason, that a reference to a contract as a future thing seems to

6. See, for instance, *May and Butcher Ltd. v. R.* [1934] 2 K.B. 17, H.L.

7. (1908) 5 C.L.R. 647, at 650.

8. An example is the judgment of Sargant L.J. in *Chillingworth v. Esche* [1924] 1 Ch. 97, C.A., at 114.

9. Such contracts have an immediate and unconditional effect at least in so far as their repudiation by one of the parties gives rise to an action of anticipatory breach. See, e.g., *Frost v. Knight* (1872) L.R. 7 Exch. 111.

10. We might add: "or the memorandum".

negative the notion of the existence of a contract as a present thing¹¹. If it were true that the mere fact of a formal document being contemplated always suspended the contract, the law, whether reasonable or not, would be simple and certain and the manifold complexities we encounter in the cases would not exist¹². However, as Lord Blackburn observed in *Rossiter v. Miller*¹³: "... the mere fact that the parties have expressly stipulated that there shall afterwards be a formal agreement prepared, embodying the terms, which shall be signed by the parties, does not, by itself, show that they continue merely in negotiation"¹⁴. There are, in fact, numerous cases in which parties were held bound by contract even though the envisaged formal document was never executed¹⁵.

Summing up in very general terms we might say that the parties' consent to be bound is implicit in the process of settling terms whenever their contracting is purely informal, and that it is implicit in the ceremonial form of contracting whenever that is adopted¹⁶, but that there is an in-between category of cases, characterized by a formal mode of contracting and by an intermediate, less formal arrangement which, whether it be oral¹⁷ or embodied in an informal document¹⁸, may or may not possess the character of a binding contract. To clarify the line of demarcation between the two types of intermediate arrangements is a practical necessity, since these contracts, as Isaacs J. once aptly remarked, "are of considerable importance, because the circumstances giving rise to them are typical of many transactions of magnitude"¹⁹.

B: CONTRACTUAL NATURE OF FORMAL DOCUMENT

In many cases the preliminary arrangement is intended, not as a contract, but merely as an agreement on some or all of the terms of the proposed formal contract. As the High Court stated in the leading case of *Masters v. Cameron*²⁰: "The parties may have so provided either because they have dealt only with major matters and contemplate that others may or will 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"²¹. The settling of some or all of the terms of the formal contract well before the execution of the formal document is a familiar feature of contracting in set forms, and rarely gives rise to any particular difficulties of legal analysis.

11. *Bonnewell v. Jenkins* (1878) 8 Ch.D. 70, at 72.

12. See the observations of Real J. in *Russell v. Slater* [1912] St.R.Qd 237, at 251.

13. (1878) 3 App. Cas. 1124, H.L.

14. *Ibid.*, at 1151.

15. For an exhaustive list of such cases see Stonham: *Vendor and Purchaser* (1964), 24, n. 5.

16. See *supra*, text to nn. 1-9.

17. *E.g.*, *Kalnenas v. Kovacevich* [1961] W.A.R. 188. Cases of this kind are exceptional.

18. Nearly all the cases dealt with in this article exemplify this type of case.

19. *Sinclair, Scott & Co. Ltd. v. Naughton* (1929) 43 C.L.R. 310, at 319.

20. (1954) 91 C.L.R. 353.

21. *Ibid.*, at 361.

However, where the preliminary arrangement is a binding contract, it becomes somewhat difficult to assess the exact legal status of the proposed formal document.

Is it a contract in its own right or merely a memorandum or record of the terms of the initial contract? Dicta can be found which might be taken to support the latter view. In *Rossiter v. Miller*²² Lord O'Hagan stated: "... when an agreement embracing all the particular essentials for finality and completeness, even though it may be desired to reduce it to shape by a solicitor, is such that those particulars must remain unchanged, it is not, in my mind, less coercive because of the technical formality which remains to be made"²³. Similarly, Jessel M.R., in a well-known dictum from *Winn v. Bull*²⁴, described the process of executing the formal document after a binding preliminary contract has already been concluded, as "merely putting into form the agreed terms"²⁵. The High Court itself might be said to have endorsed a similar view of the formal document, when, in *Masters v. Cameron*²⁶ the first of the three broad categories of cases was characterized as follows: "... the parties have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of these 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"²⁷. None of the dicta quoted state expressly that the formal contract is a memorandum only (the character of the formal document was not their principal concern), but the suggestion that this is so appears implicit in the language used.

*Branca v. Cobarro*²⁸ shows a different view. The defendant agreed to sell a mushroom farm to the plaintiff. The memorandum of the agreed terms stated, *inter alia*: "This is a provisional agreement until a fully legalized agreement, drawn up by a solicitor and embodying all the conditions herewith stated, is signed"²⁹. The Court of Appeal held the "provisional agreement" binding. Lord Greene M.R. said: "The ordinary meaning of the word 'provisional' I should have thought was something which is going to operate until something else happens. If it was intended to show that the parties regarded themselves as entering into an agreement which was to last only until something else took its place or superseded it, the word 'provisional' would be the proper and apt word to describe that intention"³⁰. The wording of the contract and Lord Greene's explanation show that the formal document is regarded as a contract in its own right, which discharges and supersedes the provisional, preliminary contract. If this be the correct view, then we are faced with an instance of novation. The relationship between the two contracts (the preliminary and the formal contract) is summed up perfectly in

22. (1878) 3 App. Cas. 1124, H.L.

23. *Ibid.*, at 1149.

24. (1877) 7 Ch.D. 29, C.A. The dictum was quoted in full by the High Court in *Masters v. Cameron* (1954) 91 C.L.R. 353, at 363, n. 2.

25. (1877) 7 Ch.D. 29, C.A., at 32.

26. (1954) 91 C.L.R. 353.

27. *Ibid.*, at 360.

28. [1947] K.B. 854, C.A.

29. *Ibid.*, at 854.

30. *Id.*, at 858.

a passage from a joint judgment by Knox C.J., Rich and Dixon JJ. concerning a case "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"³¹. As appears from this dictum, this "two-contracts" view is regarded by their Honours as appropriate to a situation in which the terms of the preliminary and those of the final contract do not coincide. It is indeed self-evident that a formal document with terms which differ from those of the provisional contract cannot be regarded as a mere memorandum. It could, in theory, be viewed as a contractual amendment of the initial agreement³², but to regard it as an entirely new contract seems the most fitting analysis.

For the sake of completeness it should be noted that the discharge of the first contract is not necessarily total; there may be special undertakings about collateral matters, such as personal loans promised to facilitate the performance of the contract, which are intended to remain intact and continue side by side with the formal contract. The continued efficacy of such special arrangements is supported by authority³³.

A "two-contracts" analysis appears preferable not only where the differences between the initial contract and the formal document are substantial, but also where the latter is merely "fuller but no different in effect"³⁴. In view of the strict and grammatical approach of the law to problems of construction, it cannot be suggested that two different forms of words in the language of a contract (except where they are completely synonymous) can ever have precisely the same legal effect. Therefore the logic of the following judicial observation seems inescapable: "It seems to us that the very essence of a formal contract is the mutuality of consent to the precise form of words that binds the parties as the authentic expression of their common intention . . . we think that it might be difficult to say that the parties were *ad idem* until they were agreed upon the form of words that was to bind them"³⁵.

Even where the terms of the preliminary contract are incorporated into the formal document without any changes, this "two-contracts" analysis should be applied. It is a typical feature of cases in which the execution of a more formal document is contemplated, that the parties have failed to clarify whether the preliminary arrangement is to have contractual force. Because of the resulting uncertainty, they will usually regard the execution of the formal document as something more than the production of a mere memorandum. The solemnity attached by the parties to the creation of the formal document is a strong indication that a contract is being made. As Pollock remarked: ". . . the formal instrument has a force apart from and beyond that of the negotiation which fixes its terms"³⁶.

31. *Sinclair, Scott & Co. Ltd. v. Naughton* (1929) 43 C.L.R. 310, at 317.

32. For the legal consequence of such a view, see *Tallerman & Co. Pty. Ltd. v. Nathan's Merchandise (Vic.) Pty. Ltd.* [1957] S.R. (N.S.W.) 466.

33. *Ticehurst v. Moore* (1907) 7 S.R. (N.S.W.) 202. See also authorities cited by Simpson C.J., in Eq., *ibid.*, at 206 *et seq.*

34. (1954) 91 C.L.R. 353, at 360; see *supra*, at n. 27.

35. *Outer Suburban Property Ltd. v. Clarke* [1933] S.A.S.R. 221, at 225, *per* Angas Parsons and Napier JJ.

36. *Pollock on Contracts* (13th ed., 1950) 5.

Identity of the terms in the two contracts occurs with particular frequency in cases where the execution of the formal document was not merely contemplated, but undertaken as an obligation by one or both parties. Express or implied undertakings of this kind are encountered frequently. In *Sinclair, Scott & Co. Ltd. v. Naughton*³⁷, for instance, the proposed purchasers signed an informal document which contained the main terms of the proposed contract as well as the following clause: “. . . we agree to sign the contract for sale as soon as same is available”³⁸.

Even where not expressly stated, such terms are, at times, found implied in the fact that the signing of the formal contract is in some way forecast in the document. The informal document involved in *Niesmann v. Collingridge*³⁹ stated that a £1,000 portion of the purchase price was to be paid “on the signing of the contract”⁴⁰, but did not contain an express undertaking by either party to conclude the formal contract. In the High Court, specific performance of the contract was decreed and at least Rich and Starke JJ. appear to have thought that an undertaking to sign the formal contract was to be implied, since they intimated in their joint judgment that the first step in carrying out the decree would be the settlement and execution of a proper contract⁴¹.

The legal efficacy of such undertakings, of “contracts to make a contract”, is often doubted⁴². It is said quite correctly that a contract to make a contract the terms of which are not yet settled, is void: “It has long been a well-recognized principle of contract law that an agreement between two parties to enter into an agreement in which some critical part of the contract matter is left undetermined is no contract at all”⁴³. As Pollock pointed out, contractual promises of this kind lack sufficiently certain contents⁴⁴. Worse still, an agreement to be bound immediately by terms which are still to be negotiated seems self-contradictory and illusory: “An agreement to enter into an agreement upon terms to be afterwards settled between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of that agreement are settled”⁴⁵.

But these considerations do not affect an agreement to make a contract the terms of which are clearly defined. They might, for instance, be fully stated or made clear by reference in the initial contract to another document.

37. (1929) 43 C.L.R. 310.

38. *Ibid.*, at 315.

39. (1921) 29 C.L.R. 177.

40. *Ibid.*, at 180.

41. *Id.*, at 184 *et seq.*

42. See observations by Parker J. in *Von Hatzfeldt-Wildenburg v. Alexander* [1912] 1 Ch. 284, at 289.

43. *May and Butcher Ltd. v. R.* [1934] 2 K.B. 17, H.L., at 20, *per* Lord Buckmaster.

44. (1932) 48 L.Q.R. 141.

45. *Ridgway v. Wharton* (1857) 6 H.L. Cas. 238, at 305, *per* Lord Wensleydale. Illusory promises have been defined as words of promise which “are accompanied by words which show that the promiser is to have a discretion or option whether he will carry out that which purports to be a promise . . .”: *Ikin v. Cox Bros. (Aust.) Ltd.* (1930) 25 Tas. L.R. 1, at 5 *et seq.*, *per* Clark J. A promise to make a contract on terms which the promisor is not obliged to agree to, falls into this category.

Is an effective "contract to make a contract" involved in such a case? If, so Pollock submitted⁴⁶, the terms are already ascertained when the first contract is made, then the second contract is surplusage and the first agreement would be the one and only contract. This analysis was endorsed by Lord Wright, who thought that it was not very accurate to speak of a "second contract"⁴⁷. With respect, these suggestions are neither self-evident nor logically compelling. There is nothing illegal or illogical in an undertaking to provide a specified set of terms with a new and more formal contractual basis; the second contract, though identical as to its terms, differs from the first in place and time of its conclusion. Pollock's and Lord Wright's suggestions may well be based on the sentiment that a contract to repeat the conclusion of a contract already concluded—albeit in more formal manner—is futile and therefore of no moment in law. This objection can be met in two steps. First, it can scarcely be doubted that parties who contract by reference to terms which are not well recorded (even though they may be clearly identified), must be legally free to undertake to co-operate towards the production of a more perfect record of the contract. As Lord Buckmaster said: "It is, of course, perfectly possible for two people to contract that they will sign a document which contains all the relevant terms . . ." ⁴⁸. The practical importance, to the parties, of possessing a self-contained, coherent and unambiguous record of the contract places the correctness of this dictum beyond doubt. Secondly, a formal document executed in pursuance of an obligation has, like all formal contracts, the prime object of reducing the result of the parties' negotiations to a form which makes it unnecessary to refer (in contractual disputes and in litigation) to matters which have preceded the execution of the formal contract. This practical object could well be frustrated if we were to insist that the formal contract is not the real contract. After the execution of the formal contract the parties want to be entitled and are entitled to regard it and not the preliminary contract as the sole basis of their rights and liabilities⁴⁹. When time and place of contracting become controversial, we ought to be able to look at the formal document and not to be forced into the vagaries and uncertainties of its past history. This writer is content to follow the guidance of Scholl J. who stated recently that the cases condemning "contracts to make a contract" only apply where the parties have left some term still to be negotiated between themselves, and that there is no objection to parties binding themselves to the execution of a contract in a prescribed form⁵⁰.

When are the terms of the second contract too vague, and when are they sufficiently well defined by the preliminary agreement? Parties who may appear to have entered into illusory undertakings will, on closer examination, often be found to have done so on the assumption that the terms of the future contract were sufficiently well defined. This assumption may be

46. (1932) 48 L.Q.R. 141.

47. "A contract *de praesenti* to enter into what, in law, is an enforceable contract, is simply that enforceable contract, and no more and no less": *Hillas & Co. Ltd. v. Arcos Ltd.* [1932] All E.R. 494, H.L., at 505.

48. *May and Butcher Ltd. v. R.* [1934] 2 K.B. 17, H.L., at 20.

49. This does not mean that the law must for all purposes ignore the fact that the formal contract was preceded by a binding provisional contract: cf. *Commonwealth Oil Refineries Ltd. v. Commissioner of Taxation (N.S.W.)* (1937) 4 A.T.D. 464.

50. *Bosaid v. Andry* [1963] V.R. 465, at 477.

erroneous and the contract may fail in consequence, but the courts are disinclined to be the destroyers of bargains and will often find it worthwhile, in the words of Pollock, "to be ingenious and even to strain a point of form if effect can thereby be given to men's reasonable intentions and expectations"⁵¹. The question whether the parties have identified sufficiently the set of terms which they want to see included in the final contract must be answered as practical justice requires. In *Trustees Executors and Agency Co. Ltd. v. Peters*⁵² the purchaser of some land sought specific performance of an option for the sale of the said land. The option agreement stated the price, identified the land and stated further that "such sale shall be on and subject to such of the usual terms and conditions of sale of the Real Estate Institute of New South Wales as shall be applicable to sales of land of like tenure under like circumstances"⁵³. Had the parties attached the document in question, crossing out such terms as they considered inapplicable, the Court's task would have been easy. This, however, they had not done and the Court was faced with the twofold problem of selecting one of the four standard contracts currently used by the Real Estate Institute and of determining further which of the terms in the chosen document should be deleted as "inapplicable". The High Court (McTiernan, Kitto and Menzies JJ.) ordered specific performance, accepting the plaintiff's argument that the final terms were sufficiently clearly defined in the original undertaking. *De facto* this no doubt involved the exercise of some degree of judicial discretion, but in the strict view of the law it constituted merely an application—albeit a generous one—of the maxim *certum est quod certum reddi potest*.

It is submitted that whether the parties' preliminary and their final contract are different or identical in content and regardless of whether the parties merely contemplate or have positively undertaken to execute a formal document, the analysis appropriate to all these cases is that the preliminary arrangement and the final document are two separate contracts. Any attempt to confine this analysis to cases in which the terms of the two documents differ, can only lead to needless complexities and to useless distinctions.

Whether or not the formal document is regarded as a contract in its own right, its terms are clearly enforceable. Thus, the practical importance of the issue just discussed is limited; but there seem to be a few practical consequences: since the fact that a memorandum has been made in a particular jurisdiction is not sufficient to confer jurisdiction, the problem what status the formal document possesses may well be the turning point in a jurisdictional dispute where the only jurisdictional connection with the *forum* lies in the fact that the formal document has been executed there. But more importantly, if the formal document is viewed as a contract in its own right, it may well prove more resistant to claims for equitable rectification than it would be if we regarded it as a mere memorandum.

It has been observed that "it is not uncommon for solicitors in drawing formal agreements to try to vary and improve informal agreements in the

51. (1932) 48 L.Q.R. 141 *et seq.*

52. (1959-1960) 102 C.L.R. 537.

53. *Ibid.*, at 539.

interests of their principals"⁵⁴. A simple example would be a formal contract of sale which is an exact transcript of the preliminary document but for the words "with interest at the current bank rate", which the vendor's solicitor has inserted after the statement of the purchase price. Provided the preliminary arrangement was binding, and provided the purchaser has executed the formal document, one appears to be faced with a problem of enforceability. Unless the very act of executing the formal document is regarded as consideration, the vendor appears to have provided no consideration for the unilateral improvement in his legal rights. Does this mean that the formal document is unenforceable and the preliminary contract still binding? Or does the parol evidence rule prohibit proof of the fact that one party's undertaking is identical with a pre-existing obligation? Does the preliminary contract merge into the formal contract and does this obviate inquiries into the problems of consideration? Neither case law nor well-settled principle yields a clear-cut answer. The problem awaits clarification by the courts.

G: STATUS OF PRELIMINARY ARRANGEMENT

1. *The legal nature of the problem*

Occasionally the status of the preliminary arrangement becomes the subject of litigation, even though the final, formal contract has been properly executed⁵⁵. But usually, when it becomes controversial, this occurs because one of the parties refuses to execute the formal contract, and is then sued on the informal document. Where both parties have signed the document, there may be little or nothing to distinguish it from an ordinary informal contract. Provided there are no special problems of conclusion⁵⁶ or enforceability⁵⁷, a court will tend to treat the document according to its appearance. As Faucett J. observed in *Kirwin v. Pearson*⁵⁸: "The production of a paper signed by the parties affords a strong presumption that it is the complete contract"⁵⁹.

These considerations make it important "that the parties should be able to protect themselves by some suitable words from being bound by the negotiation they are conducting"⁶⁰. The phrase "subject to contract" or "subject to formal contract" is often found in preliminary documents; it has acquired a commercial significance almost as clear and unambiguous as "f.o.b." or

54. *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.* (1908) 5 C.L.R. 647, at 656, per Higgins J. For practical illustrations of this observation, see *Russell v. Slater* [1912] St.R.Qd. 237, and *Jericho v. Guglielmin* [1938] S.A.S.R. 292.

55. For an example, see *Commonwealth Oil Refineries Ltd. v. Commissioner of Taxation (N.S.W.)* (1937) 4 A.T.D. 464.

56. The terms could be too vague to be enforceable, or affected by illegality, to mention only two examples.

57. The requirements of the Statute of Frauds might not be satisfied.

58. (1882) 3 L.R. (N.S.W.) 162.

59. *Ibid.*, at 167.

60. *Santa Fé Land Co. Ltd. v. Forestal Land, Timber, and Railways Co. Ltd.* (1910) 26 T.L.R. 534, at 534 et seq., per Neville J.

“c.i.f.”⁶¹. The effect of the phrase is, with rare exceptions⁶², to stamp the preliminary arrangement as an agreement on terms only⁶³.

Unconventional words or phrases used to describe the status of the initial document are apt to lead to difficulties of interpretation. A sale note in a land transaction may contain the clause: “I, the purchaser named herein, hereby acknowledge that I have this day purchased the said property upon the terms and conditions hereinbefore stated”⁶⁴, and this clearly gives immediate effect to the sale note; but in *Branca v. Cobarro*⁶⁵, the words “. . . this is a provisional agreement . . .”⁶⁶ meant to Denning J. that there was no contract⁶⁷, and to the Court of Appeal that there was one⁶⁸.

Where the phrase “subject to contract” or some similar express statement is not used, the defendant who disputes his liability on the preliminary document is faced with a twofold task: he must convince the court (1) that the execution of a more formal document was in fact contemplated, and (2) that the preliminary document was not meant to be a binding contract.

The preliminary document itself often states, expressly or by implication, that the parties contemplate a more formal document. In *Branca v. Cobarro*⁶⁹ the contract said expressly that a “fully legalized agreement” was to be drawn up later. In *Niesmann v. Collingridge*⁷⁰ the terms of the document made the purchase price payable “on the signing of the contract”⁷¹, so that the obvious implication was that a formal contract was yet to be signed. Spelling out such implications may be difficult and can become the chief point in issue⁷².

Usually the question whether a formal document is contemplated can be answered by consulting the informal document. But this does not mean, despite misleading dicta⁷³, that the question is one of construction in the strict sense. If it were, one would expect cases in which the initial document is inconclusive to be controlled by a presumption. That this is not so appears from *Pudney v. Strong*⁷⁴. The parties negotiated for the sale of a piece of land and drew up a document which contained no indication that a more formal document

61. *Chillingworth v. Esche* [1924] 1 Ch. 97, C.A., at 114, *per* Sargant L.J.

62. One such exception is *Filby v. Hounsell* [1896] 2 Ch. 737, in particular at 741 *et seq.*

63. See observations by Lord Greene M.R. in *Eccles v. Bryant and Pollock* [1948] 1 Ch. 93, C.A., at 94, cited with approval in *Masters v. Cameron* (1954) 91 C.L.R. 353, at 363.

64. From a Victorian contract.

65. [1947] K.B. 854.

66. *Ibid.*

67. *Ibid.* Denning J.’s judgment is not reported separately.

68. *Ibid.* See, in particular, Lord Greene’s remarks at *ibid.*, 857 *et seq.*

69. [1947] K.B. 854, C.A.

70. (1921) 29 C.L.R. 177.

71. *Ibid.*, at 180.

72. This was the case in *Radium Hill Co. (No Liability) v. Moreland Metal Co.* (1916) 16 S.R. (N.S.W.) 631.

73. See, *e.g.*, *Von Hatzfeldt-Wildenburg v. Alexander* [1912] 1 Ch. 284, at 288, *per* Parker J.

74. (1888) 14 V.L.R. 758.

was to be executed. The Court admitted extrinsic evidence to show that an oral understanding to that effect had been reached⁷⁵. Indeed, such extrinsic evidence must be admissible even where it conflicts with the document, for the question concerns the conclusion (as distinct from the contents) of the contract and is therefore one of fact⁷⁶. To avoid misunderstanding it should be emphasized that here, as elsewhere in the law of contract, mere undisclosed intentions (mental reservations) are not to be regarded. If, therefore, one party intended to have a more formal document executed, but had failed to make this apparent to the other party, the law would (except perhaps for limited equitable purposes) disregard such intention.

Once it is clear that the parties intended to execute a more formal document, the question arises whether the preliminary arrangement was intended to be binding as a provisional contract. Time and again this problem has also been described as one of construction⁷⁷. Doubtless this is correct if "construction" is understood in its broad sense, as the process of giving legal meaning to all forms of contractually significant conduct. The term "construction", however, more commonly denotes the translation into legal obligations of the language of written contracts and this process is governed by the rules of construction and by the rules which curtail severely the admissibility of evidence extrinsic to the documents themselves. Whether the status of the preliminary document represents a problem of construction in this narrow sense is a question of great practical importance to which unambiguous judicial answers are not readily found⁷⁸.

The problem was argued before the High Court in *Sinclair, Scott & Co. Ltd. v. Naughton*⁷⁹ in which the status was in issue of two signed memoranda which contained provisional terms for the sale of a Queensland station property including stock and plant. The alleged purchaser based his suit for specific performance on these documents. Piper J. in the Supreme Court of South Australia held that the magnitude of the transaction and the complete lack of words of promise in the language of the documents made it impossible to conclude that the parties intended to be bound before the execution of the formal contract⁸⁰. There was evidence before the court that the defendant had stated after the signing of the documents that he had now "bought the place". Piper J. considered this immaterial:

"The matter turns on the construction of the documents, and oral statements made after signature cannot affect that"⁸¹.

On appeal to the High Court, the plaintiffs objected to this aspect of Piper J.'s judgment: "The trial judge did not take account of surrounding circumstances.

75. (1888) 14 V.L.R. 758, at 764.

76. *Pym v. Campbell* (1856) 6 El. & Bl. 379.

77. See Voumard, *The Sale of Land in Victoria* (2nd ed., 1965) 69. *Farmer v. Honan and Dunne* (1919) 26 C.L.R. 183, at 195, *per* Isaacs and Rich JJ. *Bruen v. Smith* (1908) 14 A.L.R. 700, at 701, *per* a'Beckett J.

78. For a typically inconclusive judgment, see *Tooth & Co. Ltd. v. Bryen* (No. 2) (1922) 22 S.R. (N.S.W.) 541.

79. (1929) 43 C.L.R. 310.

80. [1929] S.A.S.R. 245.

81. *Ibid.*, at 249.

Where it is a question whether there is a concluded contract or a mere negotiation, the whole of the conduct at material times must be looked at: it is not merely a matter of construction⁸². The joint judgment of Knox C.J., Rich and Dixon J.J. failed to resolve the problem of principle raised by this argument. Their Honours pointed out that the defendant's subsequent statements afforded no assistance⁸³; it is apparent, however, that they arrived at this conclusion not because they thought evidence of such statements inadmissible or irrelevant, but because they considered their evidentiary value to be negligible. This is borne out by the reference in their Honours' judgment to statements by Lords Parker and Sumner in *Love & Stewart Ltd. v. S. Instone & Co. Ltd.*⁸⁴ As Lord Sumner observed in that case, unilateral descriptions of the preliminary arrangement as a "contract" or a "sale" may simply be untrue⁸⁵. Worse still, the meaning of such statements is far from clear. Lord Parker described the inherent ambiguity from which they suffer: "The reference in the correspondence to a 'sale', a 'purchase' or a 'contract' could be readily explained by the fact that the more important terms of the proposed bargain had been mutually agreed, and in such a case it was not to be expected that the parties would fail to agree on the subsidiary terms"⁸⁶. As Higgins J. has said, there is no such thing as a "virtual agreement" in law⁸⁷, but it can scarcely be doubted that this notion is adopted in popular parlance whenever convenient: a person may well say that he has "bought the place" simply because he knows that all terms are agreed and that the prospective seller is almost certain to bind himself to the agreed terms by executing a formal document. In his dissenting judgment in *Sinclair, Scott & Co. Ltd. v. Naughton*⁸⁸ Isaacs J. suggested that the admissibility of extrinsic evidence depended on the existence of an ambiguity in the preliminary document⁸⁹. This indicates that the learned judge thought the parole evidence rule to be applicable. It is submitted with respect that this is not correct and that the High Court should have disapproved Piper J.'s dictum, since the plaintiff's objections to it were fully justified in principle.

Once it is conceded that the problem in issue is whether the preliminary arrangement constitutes a contract or merely a negotiation, there can be no doubt that the rule in *Pym v. Campbell*⁹⁰ is directly applicable. This means that extrinsic evidence is freely admissible to determine whether the document was meant to be a binding contract; that the question, in other words, is not one of construction in the strict sense, but of fact⁹¹. This was

82. (1929) 43 C.L.R. 310, at 311 *et seq.*

83. *Id.*, at 318.

84. (1919) 33 T.L.R. 475, H.L.

85. *Ibid.*, at 477. It is an open, and obviously difficult, question whether such statements can ever give rise to an estoppel.

86. (1919) 33 T.L.R. 475, H.L., at 476.

87. *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.* (1908) 5 C.L.R. 647, at 650.

88. (1929) 43 C.L.R. 310.

89. *Ibid.*, at 327. Dixon J. made a similar comment during argument: *ibid.*, at 312.

90. (1856) 6 El. & Bl. 379.

91. This submission has an important implication which should, perhaps, be made explicit: cases of *non liquet* (i.e., cases in which the evidentiary factors for and against the finding that the preliminary arrangement is a contract are evenly balanced) may well be controlled by a presumption: whatever this presumption may be, it is certain not to take precedence over evidence extrinsic to the documents.

clearly affirmed by Griffith C.J. when he stated in argument in *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.*⁹² with reference to this problem: "The surrounding circumstances, including the subsequent conduct of the parties, may be looked at to see whether the parties intended to be bound . . ." ⁹³.

Where the parties were agreed that a formal document should be drawn up later, and where they have failed to clarify the status of the preliminary document by including in it a clear and express statement, the courts will have to resolve the issue as a question of fact and good sense by reference to the document itself and all relevant surrounding circumstances. The preliminary document will be held binding if that accords with the parties' actual agreement, or, in the absence of such agreement, with their justified expectations and the inherent merits of the case. Legal writers are not concerned with pure questions of fact⁹⁴, but a judicial finding of fact will be upheld on appeal only if it is rationally supportable by the evidence, a question which is traditionally regarded as one of law. For this reason it seems necessary to review the circumstances which influence the judicial determination of the status of preliminary arrangements.

2. *The circumstances to be considered*

The terms of the initial document may carry more or less clear implications about its contractual nature. Where, for example, a term calls for definite acts of performance prior to or regardless of the execution of the formal document, the parties must usually have assumed that these acts were to be rendered under both the compulsion and the protection of a binding contract. The transfer of sheep or cattle stations often calls for elaborate preparations, such as the branding and mustering of the animals. A vendor would hardly be prepared to engage in these preparations without a contractually secured expectation that the other party would not call off the deal⁹⁵. Where the action called for is less onerous and its effects readily reversible, as in the case where one party is to pay a deposit⁹⁶, the same conclusion does not necessarily follow.

In *Masters v. Cameron*⁹⁷ the High Court appears to have indicated that a preliminary arrangement had to be regarded as a contract, whenever it contained a complete statement of the proposed terms and made performance of one or more of the terms conditional upon the execution of the formal document⁹⁸. With respect, the truth of this suggestion is not self-evident. One might support it by arguing that where only performance has been made conditional in this way, the balance of the contract must be free from the

92. (1908) 5 C.L.R. 647.

93. *Ibid.*, at 663.

94. See *Qualcast (Wolverhampton) Ltd. v. Haynes* [1959] A.C. 743, H.L., at 759 *et seq.*, especially at 760, *per* Lord Denning.

95. Isaacs J. relied on similar considerations in his dissenting judgment in *Sinclair, Scott & Co. Ltd. v. Naughton* (1929) 43 C.L.R. 310, at 319 *et seq.*, in particular at 324.

96. As was the case in *Masters v. Cameron* (1954) 91 C.L.R. 353.

97. (1954) 91 C.L.R. 353.

98. See the second of the three suggested categories: *ibid.*, at 360.

condition. Such an argument would, however, beg the question whether there is a contract and would, at any rate, be far too abstract to carry any practical persuasive weight. A warning, given by a term of the preliminary arrangement that an act of performance is due immediately upon the execution of the formal document, seems in no way inconsistent with a finding that the initial document was an agreement on terms only. After all, performance in such a case falls due *under the formal contract*. *Farmer v. Honan and Dunne*⁹⁹ is a case in point. The parties came to a preliminary understanding about the terms of a proposed agreement for the sale of a station property. Clause 2 of the informal document called for payment of a deposit of £1,000 on signing of the formal contract¹⁰⁰. The plaintiff (the alleged vendor under the arrangement) sued the alleged purchaser for damages after the latter had refused to execute the formal contract; his action succeeded before Sly J. and a jury¹⁰¹. Ultimately, however, the High Court (Barton, Isaacs and Rich JJ.) held that the evidence did not support the finding that the preliminary arrangement was a contract. Their Honours pointed out that the decision depended on the wording of the preliminary document viewed in relation to the surrounding circumstances¹⁰². They attributed no particular significance to the fact that a substantial part of the purchase price was made payable immediately upon execution of the formal contract.

The more formal, detailed and precise the preliminary document appears, the stronger the presumption that it was intended as a binding contract. But an appearance of precision and completeness is never conclusive, and some other circumstance, such as the fact that the preliminary arrangement was not reduced to writing, may be a strong countervailing consideration. In *Kalnenas v. Kovacevich*¹⁰³, for example, the parties, intending to execute a formal lease later, agreed orally that the prospective lessee was to hold on the same terms as the previous lessee. This simple arrangement settled the terms in complete detail, which fact must have helped the Court to decide that it was binding. Though it is not clear from the judgment, it seems likely that other circumstances pointed to the same conclusion¹⁰⁴; otherwise the Court might have been expected to attribute greater significance to the absence of a written document.

Imprecision and vagueness of the preliminary terms often indicate that the parties have not yet agreed to be bound¹⁰⁵. It is, however, typical for preliminary arrangements, even where they are meant to bind the parties, to lack the polish and perfection which only the hand of an expert draftsman can bestow. This should be remembered when the rules concerning vagueness of terms are applied. Related to vagueness is the problem of incompleteness of terms. Where a document, to take a particularly clear example, lists only the obligations of one of the parties, the incompleteness is obvious. But terms are not complete merely because they are *capable* of constituting a contract; they

99. (1919) 26 C.L.R. 183.

100. See *ibid.*, at 187.

101. *Id.*, at 185.

102. *Id.*, at 192, and especially at 195.

103. [1961] W.A.R. 188.

104. No express reliance is placed on such additional factors in the reported judgment: see *ibid.*, at 191.

105. *Scammell v. Ousten* [1941] A.C. 251, H.L.

must be regarded as complete by the parties. Where, for example, a detailed draft contract is submitted by one, and accepted by the other party, there can be no contract if the acceptor knows that the other party regards the document as not covering all the contingencies which need to be provided for¹⁰⁶. That parties regarded a statement of terms as incomplete will often be apparent from the fact that they continued negotiations about further terms. But the occurrence of such negotiations must be seen in their proper context. As counsel correctly stated in *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.*¹⁰⁷: "Where there is a clear contract by letters, a subsequent proposal to add a new term does not affect the existence of the contract"¹⁰⁸. This rule applies with particular force and frequency to preliminary arrangements which are to be followed by more formal contracts. Even where the preliminary arrangement is meant to be a binding contract in itself, it is still quite typical for further negotiations to occur which are aimed at amplifying and perfecting the terms of the bargain. Thus, the occurrence of such negotiations is rarely an indication that the preliminary arrangement was not meant to possess contractual force¹⁰⁹. Nor can proposals for the adoption of new terms, or even for the modification of existing terms, normally be treated as a repudiation of the preliminary contract¹¹⁰.

The nature and importance of the transaction revealed by the preliminary arrangement is often significant. In *Sinclair, Scott & Co. Ltd. v. Naughton*¹¹¹ Piper J. held that the parties could not have meant their preliminary statement of terms to have been binding, since the transaction concerned a large and valuable station property. Where the transaction is important to the parties and where the preliminary arrangement is an oral one only, it will usually not be possible to find that the parties meant to be legally bound before the execution of the final document. This is particularly so where the transaction has to be in writing to be enforceable¹¹². The impression that the preliminary arrangement is not meant to be binding is strengthened by the fact that the whole arrangement is made subject to further conditions, for instance the availability of bank finance¹¹³.

Sometimes, the manner in which the preliminary arrangement is concluded, provides the decisive clue. Even in layman's language, the terms "offer" and "acceptance" have come to symbolize the making of a binding contract. Therefore, where one party communicates a firm contractual proposal to another and calls it an "offer", assent to the proposal which the recipient of the proposal calls "acceptance" will normally result in a binding contract, and the acceptor cannot be sure of nullifying this effect by adding to his

106. See e.g., *Russell v. Slater* [1912] St.R.Qd., 237.

107. (1908) 5 C.L.R. 647.

108. *Ibid.*, at 664. This principle is well-settled (see *Lennon v. Scarlett & Co.* (1921) 29 C.L.R. 499, a 509, and *Dinan v. Harper* [1922] V.L.R. 49); indeed, it seems self-evident.

109. *Lennon v. Scarlett & Co.* (1921) 29 C.L.R. 499.

110. *Ibid.*, particularly at 509.

111. [1929] S.A.S.R. 245.

112. *Murray v. P. A. Westbrook & Son (Bowral) Pty. Ltd.* (1958) 75 W.N. (N.S.W.) 492.

113. *Ibid.*

"acceptance" that it would be desirable to have a more formal contract drawn up. In *Bruen v. Smith*¹¹⁴ the plaintiff had answered such a firm offer as follows: "I accept your offer . . . to purchase my properties . . . for the sum of £1,450 cash. Formal contract to be signed"¹¹⁵. a'Beckett J. pointed out that if the second sentence had not been added, no doubt could have been entertained that there was a contract¹¹⁶. As for the addition, a'Beckett J. held that only if it had been an express statement that no contract was to come into existence until the formal document was signed, would it have suspended the conclusion of the contract. In *Lennon v. Scarlett & Co.*¹¹⁷ the defendant had replied to a telegram offering maize on stated conditions: "Accept five hundred tons prime maize sixteen pounds aboard Cairns July or August. Please forward contract"¹¹⁸. The High Court (Knox C.J., Higgins and Starke JJ.) accepted the plaintiff's argument that this had been "a clear acceptance of a full offer in which the parties, the subject matter, the price, and the place and time of delivery were stated"¹¹⁹. The opposite result may be indicated where not the acceptance, but the offer states that a more formal document is to be signed. In *Farmer v. Honan and Dunne*¹²⁰, for example, the plaintiff proposed to sell to the defendant a station property on specified terms. The written proposal was couched in the terms of a firm offer, but clause 2 called for payment of a deposit "on signing of the contract of sale"¹²¹. The defendant accepted the offer in absolute terms and without making any reference to a more formal contract. Counsel for the plaintiff cited a number of cases which, like *Bruen v. Smith*¹²² and *Lennon v. Scarlett & Co.*¹²³, had held that the acceptance of a definite offer is not effectively qualified if the acceptor adds a mere reference to a formal contract¹²⁴. However, in a joint judgment Isaacs and Rich JJ. distinguished these cases: ". . . in this case, the stipulation as to a formal contract is not a collateral addition by the offeree. It is part of the offer itself, and an acceptance of the offer must include that term"¹²⁵. The distinction seems tenuous; at any rate, it would be a mistake to apply it strictly. Whether the reference to a more formal contract appears in the offer or the acceptance, it will never give rise to more than a *prima facie* inference which may or may not survive scrutiny of all the circumstances.

Where the preliminary arrangement has resulted, not from the acceptance of an offer, but from the exercise of an option, it would normally not be rational to deny binding force to it. In *Niesmann v. Collingridge*¹²⁶ the

114. (1908) 14 A.L.R. 700.

115. *Ibid.*

116. *Ibid.*, at 701.

117. (1921) 29 C.L.R. 499.

118. *Ibid.*, at 501.

119. *Id.*, at 506.

120. (1919) 26 C.L.R. 183.

121. *Ibid.*, at 184.

122. *Supra*, at n. 114.

123. *Supra*, at n. 117.

124. (1919) 26 C.L.R. 183, at 196; see also the argument by Innes K.C., *ibid.*, at 186.

125. *Id.*, at 196.

126. (1921) 29 C.L.R. 177.

defendant granted the plaintiff a written option to buy certain land on specified terms. As stated in the option, the terms of the proposed contract made a portion of the price payable "on the signing of the contract"¹²⁷. This phrase implied clearly that the execution of a formal document was contemplated, but said nothing about the legal standing of the preliminary agreement which would result from the execution of the option¹²⁸. A consideration of sixpence had been paid for the option which showed that the option itself was meant to be legally binding. It followed that the agreement resulting from the exercise of the option was to be binding too—otherwise the "binding" option would have been illusory. Defendant's counsel denied this in his argument, but Knox C.J. gave what seems the only possible answer: "... it is apparent that the right to insist on the continuance of an offer which is incapable of being converted by acceptance into a contract is entirely illusory. I find it impossible to entertain the idea that the parties intended this so-called "firm offer" should be so futile a proceeding as the appellant now contends"¹²⁹. Accordingly, the court held the defendant bound by the preliminary arrangement¹³⁰.

Not only the immediate steps which have led to the preliminary arrangement, but also the circumstances surrounding these steps, can be of decisive significance. For instance, in *Pudney v. Strong*¹³¹ the Court held that the preliminary document involved in the case was intended to have immediate effect: decisive considerations were that the signing of the document had been preceded by protracted discussions and deliberations, that the defendant had repeatedly consulted his partners during this period, and that the document had been signed by both parties in a solemn manner after it had been read out aloud¹³².

In view of the heavy bias of many modern writers against the admission of subjective considerations, it is of theoretical as well as of practical interest to inquire whether direct evidence of intention is admissible to determine the contractual status of preliminary arrangements. If a party, whilst outwardly making an absolute contract, entertained an undisclosed intention not to be bound, the law would ignore this mental reservation. Evidence tendered to prove it would be irrelevant and therefore inadmissible. Does the same prohibition apply where the intention not to be bound was common to both parties, or where one party knew of the other's intention not to be bound? An affirmative answer seems implicit in a dictum from the joint judgment by Isaacs and Rich JJ. in *Farmer v. Honan and Dunne*¹³³: "It is a recognized rule of construction of a written document put forward as a contract, that

127. (1921) 29 C.L.R. 177, at 180.

128. It must be remembered that in a case such as *Niesmann v. Collingridge* we are dealing not with two, but with three contracts: (1) the option agreement (an agreement that the offer shall not be withdrawn for a specified period), (2) the bilateral contract which results from the acceptance of the offer, and (3) the formal contract which supersedes the agreement specified under (2).

129. (1921) 29 C.L.R. 177, at 183.

130. *Goodwin v. Temple* [1957] St.R.Qd. 376 was a case to the same effect as *Niesmann v. Collingridge*. See also *Australian Can Co. Pty. Ltd. v. Levin & Co. Pty. Ltd.* [1947] V.L.R. 332.

131. (1888) 14 V.L.R. 758.

132. *Ibid.*, at 768 *et seq.*

133. (1919) 26 C.L.R. 183.

direct extrinsic evidence cannot be given of the intention of the parties"¹³⁴. With respect, the prohibition referred to by their Honours does not apply whenever a party cares to *put forward* a written document as a contract; *Pym v. Campbell*¹³⁵ is conclusive authority against such a view. It becomes applicable only when the document has been *established* as a genuine contract and this depends to a large extent on their subjective agreement and common understanding. Evidence of these matters, whether direct or circumstantial, must be admissible.

Where the preliminary arrangement and the circumstances surrounding it provide insufficient guidance, the parties' subsequent conduct may show whether they meant to be bound. That such evidence is freely admissible has already been demonstrated¹³⁶. Unilateral statements about the legal effect of the preliminary documents have little, if any, evidentiary weight¹³⁷. But actions, or even statements, by both parties are in a different category. *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.*¹³⁸ was concerned with an arrangement under which the defendants, shipowners, were to use the plaintiffs' wharf at Port Pirie in South Australia at a specified rate for a period of two years. The initial correspondence about this projected contract terminated with a letter by the defendants: "We are willing to conclude with you for wharfage on the basis of sixpence per ton and will be glad if you will make a contract for our approval and signature"¹³⁹. To this letter the plaintiffs replied: "I note with pleasure that you have decided to accept the wharfage rate of sixpence per ton as per correspondence which has passed, and I will arrange a contract accordingly"¹⁴⁰. No formal contract was ever signed, the defendants repudiated the arrangement and the plaintiffs sued for damages. The action was brought in the High Court, and Higgins J. held that the parties, though they might have been agreed on all the terms of the proposed contract, had not agreed to be bound by these terms and that therefore no contract had ever been concluded. His Honour placed considerable reliance on subsequent correspondence about the signing of the formal contract, details of performance and additional terms in which both parties, by using terms such as "proposed contract" and "preliminary arrangements" and in other ways, showed that they did not regard themselves as contractually bound. Higgins J.'s judgment was affirmed on appeal by the Full Court. Griffith C.J. not only agreed with Higgins J.'s assessment of the subsequent correspondence, he was even prepared to allow for the possibility that such subsequent correspondence could override a contrary *prima facie* conclusion which appeared from the circumstances surrounding the preliminary arrangement itself: "I think further that, if *prima facie* [the letters] disclosed a contract, the subsequent correspondence shows that it was not in the contemplation of either party that they

134. *Ibid.*, at 195.

135. (1856) 6 El. & Bl. 379.

136. See *supra*, text to nn. 74-87.

137. *Love & Stewart Ltd. v. S. Instone & Co. Ltd.* (1919) 33 T.L.R. 475, H.L., at 476 *per* Lord Parker, and at 477 *per* Lord Sumner.

138. (1908) 5 C.L.R. 647.

139. *Ibid.*, at 648.

140. *Ibid.*

were to be bound until all the essential preliminaries had been agreed to, nor until a formal contract had been drawn up embodying all the matters incidental to a transaction of such a nature"¹⁴¹. With respect, this seems correct in principle.

If subsequent statements by the parties are admissible, so must be other subsequent conduct, for "actions speak louder than words". Where parties commence performance under a preliminary arrangement prior to the signing of the formal contract, the only rational inference must often be that they intended the arrangement itself to be binding, particularly where the acts of performance are onerous and their effects irreversible. Where this is not the case, for instance where money has been paid which can readily be repaid, a different conclusion may be appropriate; the understanding between the parties might have been that the acts in question should be regarded as acts of performance if a contract should be concluded, whilst otherwise they should be reversed. It was this significance which the High Court attributed to the payment of a deposit under a preliminary arrangement for the sale of a farming property in *Masters v. Cameron*¹⁴². In that case the parties signed a document containing terms for the sale of the respondent's farm to the appellants. *Inter alia*, this document provided: "This 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, and to the giving of possession on or about the fifteenth day of March 1952"¹⁴³. The appellants paid to Dalgety & Co., the respondent's agents, £1,750 described in a receipt as "deposit on purchase 'Bokhara' Farm"¹⁴⁴. Subsequently, the appellants repudiated the transaction and claimed the money back from the agents. The respondent filed a competing claim based on the contention that the money was due to her, since the appellants had broken their contract. Doubtless the payment of the deposit was strong indication that the document was meant to be binding and Wolff J. (W.A.) found for the respondent, presumably relying on the payment of the deposit. However, the High Court reversed this judgment, placing chief reliance on the terms "subject to the preparation of a formal contract", which, it was said, "prima facie create an overriding condition, so that what has been agreed upon must be regarded as the intended basis for a future contract and not as constituting a contract"¹⁴⁵. The payment of the deposit could be given a significance quite compatible with this prima facie conclusion, as had been done under similar circumstances in *Chillingworth v. Esche*¹⁴⁶, where Sargant L.J. had described the deposit as "an anticipatory payment intended only to fulfil the ordinary purpose of a deposit if and when the contemplated agreement should be arrived at"¹⁴⁷. This assisted the High Court in concluding that the money was paid "on terms which required that

141. (1908) 5 C.L.R. 647, at 669.

142. (1954) 91 C.L.R. 353.

143. *Ibid.*, at 354.

144. *Ibid.*

145. *Id.*, at 353.

146. [1924] 1 Ch. 97, C.A.

147. *Ibid.*, at 115.

if a formal contract should be executed the account should be applied and treated as a deposit on the purchase so contracted for, and that otherwise it should be returned to the appellants"¹⁴⁸.

3. *Cases involving a non liquet*

Cases might occur in which the factors pointing in favour of and those pointing against the conclusion that there is a contract are evenly balanced. It has been suggested that such cases are controlled by the ordinary rule of evidence that the plaintiff, in order to prevail, must prove his case, and that he will lose if the odds are even. This certainly is the solution if all else fails, but it produces arbitrary results, since it forces the courts to treat the contract as either established or not established, depending on which party happens to be the plaintiff: an action for specific performance (based on the existence of a contract) would fail, but so would an action for the return of a deposit (based on the absence of a contract).

It is submitted that the law does not create this dilemma: rather, cases of *non liquet* are controlled by a presumption. In *Ridgway v. Wharton*¹⁴⁹ Lord Cranworth L.C. stated: "I again protest against its being supposed, because persons wish to have a formal agreement drawn up, that therefore they cannot be bound by a previous agreement, if it is clear that such an agreement has been made; but the circumstance that the parties do intend a subsequent agreement to be made, is strong evidence to show that they do not intend the previous negotiations to amount to an agreement"¹⁵⁰. This dictum was accepted as correct by Higgins J. in *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.*¹⁵¹. Isaacs J., too, endorsed virtually the same proposition, when he stated during argument: "The sending of a document to a solicitor is cogent evidence that the parties did not intend to be bound until a formal contract is signed . . ."¹⁵²

In apparent opposition to these views are judicial dicta which could be interpreted as implying that the mere fact that parties have settled the terms of a proposed contract is some evidence that they intended to be bound by these terms¹⁵³. In *Rositer v. Miller*¹⁵⁴, to quote a particularly well-known example, Lord Blackburn stated: ". . . the mere fact that the parties have expressly stipulated that there shall afterwards be a formal agreement prepared, embodying the terms, which shall be signed by the parties does not, by itself, show that they continue merely in negotiation . . . as soon as the fact is

148. *Masters v. Cameron* (1954) 91 C.L.R. 353, at 366.

149. (1857) 6 H.L. Cas. 238.

150. *Ibid.*, at 268.

151. (1908) 5 C.L.R. 647, at 662.

152. *Ibid.*, at 663.

153. In *Bicknell v. Bell* (1897) 3 A.L.R. 162 a Beckett J. held a preliminary agreement binding and stated his conclusion as follows:

"In *Hawksworth v. Chaffey* 54 L.T.N.S. 72, a case relied on by the defendant, there was clearly matter for further negotiation which had to be settled before the contract would be signed. Here the negotiation was at an end, and £100 was paid as on a concluded transaction."

This might be said to be misleading because equal evidentiary weight is attributed to the fact that the terms are settled and to the payment of the deposit. The former factor is, however, completely neutral. See also: *Morrison v. Neill* (1875) 1 V.L.R. (L) 287.

154. (1878) 3 App. Cas. 1124, H.L.

established of the final mutual assent of the parties so that those who draw up the formal agreement have not the power to vary the terms already settled, I think the contract is completed"¹⁵⁵. This dictum seems indeed to imply that whenever the draftsman who is to produce the final draft of the contract is presented with terms the parties have settled with some finality, then the "final mutual assent" is established. If this were the correct interpretation, then the dictum would be subject to Mr. Justice Higgins' strictures:

"There is no contract unless the two parties mutually consented to be bound one to the other by one agreement. Moreover—though it ought to be superfluous to say it—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. I have found, in my experience, that the two processes are frequently confounded; and, if I may judge from some of the cases to which I have been referred by Mr. Starke, the confusion has not always been avoided even in the courts"¹⁵⁶.

The principle expressed in this dictum is so fundamental that the Australian courts would not be persuaded of its unsoundness even by the House of Lords¹⁵⁷. But it is further submitted, that Lord Blackburn meant to refer to the parties' agreement to be bound and not to their mere agreement on terms when he used the words "final mutual assent". Thus understood, no exception can be taken to the dictum. Once doubtful dicta have been correctly understood, there is no real authority opposed to the view of Lord Cranworth, as endorsed by Higgins and Isaacs JJ. Actual practice in the courts, however, does compel us to qualify Lord Cranworth's words in one respect: the mere fact that the parties contemplate that a formal agreement is to be drawn up, is certainly some, but hardly strong evidence that the parties do not wish to be bound. If it were strong evidence, then it would virtually be in the same category as the phrase "subject to contract" appearing in a preliminary document. As the cases show, however, the mere fact that a formal document is contemplated is rarely relied upon as a decisive consideration.

D: CONCLUSION

A survey of the Australian cases concerned with arrangements contemplating the execution of a more formal document leads to the following conclusions.

1. Negotiating contractual terms usually signifies that the parties intend to be bound as soon as the terms are settled. This *prima facie* inference is, however, not appropriate where the execution of a more formal document is contemplated. In such cases the initial settlement of terms is sometimes held binding as a contract, but at other times it is regarded as a mere statement of terms without contractual force.
2. The legal relationship between the preliminary arrangement and the formal contract raises some complex legal issues. In theory, there are the following possibilities:

155. (1878) 3 App. Cas. 1124, at 1151.

156. *Barrier Wharfs Ltd. v. W. Scott Fell & Co. Ltd.* (1908) 5 C.L.R. 647, at 650.

157. Cf. *Parker v. The Queen* (1963) 37 A.L.J.R. 3; *Skelton v. Collins* (1966) 39 A.L.J.R. 480.

- (i) The initial arrangement is an agreement on terms only; no contract exists until the formal document has been duly executed.
 - (ii) The initial arrangement is intended as a provisional, but binding contract, to be superseded and discharged by another, more formal contract.
 - (a) This analysis is unquestionably appropriate whenever the parties envisage that the formal contract might have terms different from those of the initial contract.
 - (b) The same analysis should be applied where the parties intend, or even undertake, to conclude the formal contract on terms identical with the terms of the preliminary contract. It is no valid objection to this submission, that it turns the preliminary arrangement into a "contract to make a contract". As long as the terms of the final contract are sufficiently identified, a contract to make a contract is legally effective. In assessing whether the terms are sufficiently identified, the courts have steered clear of pedantry so as not to disappoint reasonable expectations of the parties.
 - (iii) Occasionally, it may be appropriate to view the execution of the formal document not as the conclusion of a separate contract, but merely as the production of a memorandum or record of the original contract; it is submitted, however, that such cases are exceptional.
3. Differences between the terms of the two contracts (the initial and the formal), which affect the position of one party only, give rise to a problem of enforceability, since it is doubtful whether the unilateral change in the parties' obligations is supported by consideration. One could, perhaps, regard the very act of executing the formal document as consideration.
 4. The question whether the preliminary arrangement is a contract must be resolved by taking into account all relevant circumstances. The problem is one of fact or of construction in the broad sense (that is, the process of giving legal meaning to all forms of contractually significant conduct); it is not a problem of construction in the strict sense (that is, the process of establishing the legal meaning of written contracts). Express statements in the preliminary document, such as "subject to contract", possess great evidentiary weight and usually, though not always, override other considerations.
 5. Express statements, the condition of the preliminary document, the nature of the transaction, the surrounding circumstances, the steps leading up to the production of the preliminary document, the parties actual intentions as well as their subsequent conduct, may all be legitimately resorted to, where they seem relevant, to determine the status of the preliminary arrangement.
 6. Where all the relevant circumstances have been examined and a *non liquet* still remains, the law presumes that the preliminary arrangement was not meant to be binding.