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Many agreements set out brief details, with more information to be provided later. A Court of Appeal case (*ECNZ v. Fletcher Challenge*) shows the dangers that lurk. Wigley & Company will deal with the risks and solutions. This article was first published in the National Business Review.

Often, the risk of a short outline deal turning pear-shaped is outweighed by the commercial need to move quickly to a binding contract. Where risk and dollars are substantial, it would be safer to get the lawyers involved at the outset.

Businesses often negotiate agreements without dealing with all the detail. "Back of the envelope" and oral agreements even for multimillion-dollar deals are common.

Obviously there is a risk in this but it's commercial reality.

A recent Court of Appeal decision, *ECNZ v Fletcher Challenge Energy*, demonstrates the dangers lurking for companies that want such agreements to be binding – and for those that don't.

In that case, one of these "shorthand" contracts was under the microscope – a Heads of Agreement (HoA).

Using structures like HoAs, business people often negotiate deals that record only the key terms, leaving the detail to be sorted out later. For example, business managers can agree the outline of the deal, leaving the lawyers to produce a full agreement some time down the track.

Heads of Agreement is a fancy name for an agreement that can take many forms and might not even be called that.

HoAs can include: an exchange of letters, something that looks like a lawyer's agreement, and even a purely oral agreement.

Sometimes there is so little detail in an HoA that at least one party may think there is no binding contract until the full agreement is signed up.

However, the ECNZ decision should sound a warning for management who might be planning to flesh out the contract at a later stage.

Fletcher and ECNZ managers signed a four-page HoA in bullet-point format.

It set out most, but not all, of the key terms of a complex 17-page gas supply contract worth more than $1 billion. Some terms were left open for resolution.

But before signing a comprehensive legal agreement, ECNZ wanted to pull out.

ECNZ was lucky. Most of the Appeal Court judges decided the parties didn't intend that the HoA would be binding immediately; the deal would be enforceable only after more terms were agreed.

The minority judgment shows ECNZ came within a whisker of being caught in a billion-dollar deal it didn't want.

There is a two-step process in looking at these situations. First, did the parties to the shorthand contract intend to be bound immediately?

Second, if they did intend to be bound, are the words in the contract (and in the surrounding circumstances) sufficient to establish the essential terms of the agreement?

ECNZ won on the first step but the Court addressed the second step anyway.

It decided it would have been able to flesh out the scanty and incomplete HoA words to make the deal binding. It would do all it could to implement a commercial agreement the parties wanted, backing away only where it was too difficult to work out the essential terms.

The ECNZ case shows how far the courts can go to fill in gaps in patchy commercial agreements. To work out the essential terms, they use techniques such as:

- looking at the factual background from various sources (not just the shorthand contract itself) to decide what the missing or unclear terms should be;
- implying terms; and
- leaving out what they consider are non-essential terms.

This last point demonstrates the enormous potential dangers in shorthand contracts. What a court says is non-essential might differ considerably from a commercial view of what is non-essential. A key example is limitation of liability.

If this is not covered expressly in the HoA, a court can leave it out of the agreement. Yet many suppliers regard limiting their liability (eg: for lost profit) as very important. A supplier can end up committed to a deal, carrying unwanted and dangerous high-dollar-value risk.

So what should a business do if it wants an agreement in principle which is not binding until a full legal agreement is completed?

It should simply add to the document something that says just that. It is too risky to leave this to chance and it's much safer to be upfront.

What about where the business wants the HoA to be binding?

This is very common. Working under time pressure, one or both parties want to make sure the deal is tied down even though more work is needed to flesh out the detail.

Sensible precautions can include:

- Add something like: "This agreement is binding immediately." The full agreement later will simply implement the existing binding contract.

- As far as possible, cover key points carefully. An awkward example is limitation of liability. If little or nothing is said, a court won't usually put in a suitable liability limitation clause. Also, even lawyers can struggle with drafting these often difficult clauses (and many clauses in standard contracts are deficient). So, adding suitable words on the fly could be risky. One option: the supplier could plug in its usual limitation of liability clause.

- The documents don't have to look like a lawyer's contract. Usually, a letter signed by both parties will do the trick.

- Where a term is yet to be resolved, one option is to put in a benchmark from which a court can decide what the particular term should be.

- Insert an arbitration clause. This greatly enhances the prospect of a patchy deal being fleshed out and made enforceable. The clause can be detailed (and specifically cover resolution of contract terms) but something simpler normally works. For example, "All disputes arising out of or in connection with this contract will be determined under the Arbitration Act 1996." A simple example of how this works is pricing. If that isn't sorted out when the HoA is signed, an arbitrator can often decide what a reasonable price would be. One party might not like the "reasonable" price but at least a deal would have been concluded quickly. Almost always, price will be agreed later without having to go to arbitration (so, often this will be an acceptable commercial risk).

Often, the risk of a short outline deal turning pear-shaped is outweighed by the commercial need to move quickly to a binding contract. Where risk and dollars are substantial, it would be safer to get the lawyers involved at the outset.

Wigley & Company is a specialist technology (including IT and telecommunications), procurement and marketing law firm founded 11 years ago. With broad experience in acting for both vendors and purchasers, Wigley & Company understands the issues on "both sides of the fence", and so assists its clients in achieving win-win outcomes.

While the firm acts extensively in the commercial sector, it also has a large public sector agency client base, and understands the unique needs of the public sector. While mostly we work for large organisations, we also act for SMEs.

With a strong combination of commercial, legal, technical and strategic smarts, Wigley & Company provides genuinely innovative and pragmatic solutions.

The firm is actively involved in professional organisations (for example, Michael is President of the Technology Law Society and Stuart van Rij its secretary).