Bindingness and Implications of 'Pre-Agreements'

- Letters of Intent, Memoranda of Understanding, Term Sheets and Heads of Agreement

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Introduction

In an ideal world, parties to a contract are expected to finalise their business dealings and sign a written agreement before performance of the contract begins. The general nature of a contract is that parties negotiate terms and conditions of their proposed transaction, and draw up a formal contract expressing rights, obligations and relationship of the parties prior to performance. However, in reality, parties are sometimes under commercial pressure to "get the show on the road" or commence work as soon as possible. As such Letter of Intent (**"LOI"**), Memorandum of Understanding ("**MOU**"), Term Sheets **("TS"**) and Heads of Agreement **("HOA"**) are preliminary documents ('pre-agreements' or 'agreements to agree') commonly used by parties to document their expectations regarding potential negotiation outcomes pending the completion of a final contract.

Pre-Agreements: Uniqueness/Similarities?

An **LOI** basically outlines the intention of one party to another and usually signed by the party expressing that intent, whereas an **MOU** needs to be signed by (both or all) parties. **MOU** describes agreement between parties which expresses a common intended line of action. Oftentimes, it is used in cases where parties do not imply contractual or enforceable agreement between them.

The notion of **LOI** and **MOU** is almost similar to **TS** and **HOA**. A **HOA** is a usually more detailed and lengthy than a **TS** which sets out the agreed terms (outline) of the proposed contract. Typically **HOAs** take greater time to document than **TS** and are more appropriate where complex negotiations in a transaction are contemplated. If there is a time-bound exclusivity provision in a **TS**, breach thereof would be actionable if the stated period has not expired. Same applies to: confidentiality, costs (break fee) and dispute resolution clauses; these could be, and in many cases have been held to be, binding even if other provisions are not. It has become almost a transactional convention that you must have **TS** to guide your negotiations. Sometimes it is a useful indicator – because if parties cannot agree a **TS**, then there is little prospect of getting to full contract! What are key things to be mindful of in drafting **MoUs** and why? If it turns out that all the parties have is the **MoU**, and had they anticipated that would be the case, could they have put some provisions in the **MoU** as part of their risk management strategy?

Importance of 'Contracts' and Courts' Burden

The importance of having a legally binding contract in place between parties cannot be over-emphasized, as it connotes certainty. Where this is not the case, courts are left with the burden of having to decide whether or not a binding agreement exists between both parties. This was the challenge that confronted the Court in ***RTS Flexible Systems Ltd v. Molkerei Alois Müller Gmbh & Company KG (UK Production) [2010] UKSC 14***. In that case, Müller a well-known producer of dairy products commissioned RTS to install two new production lines at its factory. **LOI** was entered into between both parties in March 2005 pending a full contract to be agreed upon by both parties. However, by the time the **LOI** expired on 27 May 2005, the contract had not been agreed. By July 2005, the price for the work had been agreed (£1,682,000) as were almost all the contractual terms; however, no contract was ever entered into. The relationship subsequently broke down in November 2005; and RTS sought payment for work already done, from Müller. Müller counterclaimed for its losses from the failure of the new production line.

The UK Supreme Court (at *para* 45 of the judgement) analysed that: "*the general*

principles are not in doubt. Whether there is a binding contract between the parties and, if so, upon what terms depends upon what they have agreed. It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations." The Court opined that in commercial context, contracts can be accepted through performance, and the fact that a "***transaction was performed on both sides will often make it unrealistic to argue that there was no intention to enter into legal relations and difficult to submit that the contract is void for vagueness or uncertainty***". Thus the Court found there existed a binding contract between both parties.

It is hornbook law that the basic requirements for formation of a legal contract are: offer, acceptance of offer, consideration and intention to create legal relations; absence of any element is fatal. In ***Dodo v. Solanke [2007] ALL FWLR (Pt. 346) 576 at 592G – 593A, Kekere Ekun JCA*** (as she then was) held that, "*a contract is an agreement between two or more parties which creates reciprocal legal obligation or obligations to do or not to do a particular thing. For a valid contract to be formed, there must be mutuality of purpose and intention. The two or more minds must meet at the same point, event or incident. Where or when they say different things at different times they are not ad idem and therefore no valid contract is formed. The meeting of minds of the contracting parties is the most crucial and overriding factor or determinant in the law of contract.*"

In ***Robinet Nigeria Ltd v. Shell Nigeria Gas Ltd [2013] LPELR-22144*** the Court reached the same conclusion per ***OSEJI, JCA*** at ***26F*** that: "*… the meeting of minds of the contracting parties is the most crucial and overriding factor or determinant in the law of contract.*"

Why Use LOIs/MOU/TS/HOA?

There are numerous reasons why parties may not commit their 'final' agreements into writing before performance starts. One of such is that parties may commence work

relying on the use of an LOI/MOU/TS/HOA, as in ***Muller's case*** discussed earlier. This is a common trend particularly in the construction industry where parties may start performance due to *insufficient time,* being pressured to conclude negotiations or compelling urgency of the contract.

Trust and long-standing relationships is also one of the many reasons why parties may not commit to writing before performance commences in contract. This came into play in ***Baird Textile Holdings v. Marks and Spencer Plc. [2001] ECWA Civ 274.*** Baird had been a major supplier of garments to Marks and Spencer (M&S) for 30 years. Despite the long-standing relationship between the parties, M&S cancelled all supply arrangements. M&S did not provide Baird with any notice of termination since there was no express contract in place. The parties had dealt with each other based on trust and long-standing collaborative relationship over the years. However, it was held that the mere existence of this arrangement between the parties was uncertain; whether a contract could be implied will depend on the conduct of the parties. The courts cannot create contract for parties when there are no express terms of contract binding on them, but can only enforce agreements if they do exist. This case illustrates the potential risk of not having written contracts to govern transactions.

Other reasons why people fail to enter into binding contracts are: the *rigidity* that comes with drafting a contract and fully executing its terms and conditions, *potential costs in drafting and concluding contracts,* the *reputation or goodwill of the other contacting party*.

In Nigeria, where there is no formal contract in place, the courts are still called to settle disputes arising out of alleged 'contracts'. The pervasive rule is that our legal system often sees a formal contract as the primary source of parties' obligation in contract rather than an **LOI/MOU/TS/HOA**.

Case Law Insights

In ***Bilante International Ltd. v. NDIC [2011] 15 NWLR (Pt. 1270) 407 at 423,*** the Court held that "*a binding contract must contain the basic elements of offer, acceptance, consideration and capacity to contract or intention to create legal relationship, as opposed to an invitation to treat which is not an offer that can be accepted to lead to a contract.*" The Court held that an **LOI/MOU**, merely sets down in writing what the parties intend will eventually form the basis of a formal contract between them. Thus, taking into consideration the elements of a valid contract, the **LOI/MOU** is merely a representation of the intention of the parties, subject to the execution of a formal agreement.

Also, in ***BPS Construction & Engineering Co. Ltd v. FCDA [2017] 10 NWLR (Pt. 1572) 1 at 28 G-H, Kekere-Ekun, JSC*** held: "*it is clear that a memorandum of understanding or letter of intent, merely sets down in writing what the parties intend will eventually form the basis of a formal contract between them. It speaks to the future happening of a more formal relationship between the parties and the steps each party needs to take to bring that intention to reality… **Notwithstanding the signing of a memorandum of understanding, the parties thereto are not precluded from entering into negotiations with a third party on the same subject matter.**" (emphasis supplied)*

In ***UBA v. Tejumola & Sons Ltd [1988], 2 NWLR (Pt.79) 662,*** the SC held that despite the conduct of the parties, there was no contract between them. The facts were that the Defendants had offered to lease the Plaintiff's building for 15 years at a fixed rent. The letter was boldly headed "*subject to contract*". The Plaintiff accepted the offer and specifically stated that the lease would commence on 1st May 1982. The Defendants thereafter requested several expensive renovations to the building, which were carried out by the Plaintiff. The Defendant never took possession and the Plaintiff sued

to enforce the contract. The Court agreed with Defendant's contention that since the offer and acceptance was *"subject to contract"*, and which eventually did not materialise, there was no lease to enforce against the Defendants.

Nevertheless, depending on the wording of the relevant document and circumstances of each case, **LOI/MOU/TS/HOA** can have the binding power of a contract. A document does not necessarily have to be labelled a contract, before it is legally binding; the well-defined legal obligation in the text of a document should determine its legality.

In ***Incorporated Trustees of Nigerian Baptist Convention & Ors v. Governor of Ogun State & Ors [2016] LPELR 41134 (CA),*** The trial Court had held (as excerpted) at 25 *D-E*: *"Government would appear to have by the [MoU] negated what it purported to have given the Claimants in the letters of 15th October, 2010 as firming (sic) out the schools to them was not a return of same to them. I can see no illegality in the Agreement entered by the parties vide the **[MoU]** and I hold same binding on them."* ***Tsammani, JCA*** delivering the lead judgment (of the unanimous decision) held at *27 E-F*: *"I am therefore of the view that, it would be safe to conclusively presume that the **[MoUs]** crystallized the agreement between the Appellants and the Ogun State Government."* At *page 59*, the *learned JCA* said: *"secondly, since it has been established that the Agreements **[MoUs]** signed by the parties is still valid, subsisting and binding; AN INJUNCTION is granted, restraining the Respondents by themselves, their servants and/or agents from reversing or revoking the said Agreement, save in accordance with the terms of the **[MoU]**."*

Conclusion

The legality and enforceability of 'pre-agreements' (**LOI/MOU/TS/HOA**) will depend upon the intention (evidenced by negotiations and provisions) of the pre-agreement signed by the parties. To determine whether parties intend to be bound, the Court has to take an objective approach which can be inferred from circumstances of each case. To avoid uncertainty, clear statement and caution must be exercised while drafting the language, titles and clauses of these documents. For example, clauses on jurisdiction, governing law clause, dispute resolution, confidentiality, (time bound) exclusivity, and indemnification ('break fee') could be binding and deemed to survive these documents.

However, the questions raised here encapsulate whether a formal contract can capture the expectations of parties in commercial transactions or can parties make do with preliminary or intermediate contracts? The rule of thumb would appear to be that the higher the stakes, or the more complex the transaction prudence impels that parties take their time to conclude formal contracts in order to avoid unintended outcomes. However, the reality is that pre-agreements will always have their place and utility. It would be a matter of the commercial savvy and sophistication of parties to know what document is required at any stage and to ensure appropriate provisions and protections are enshrined in them to meet the relevant parties' business objectives.