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Letters of Intent and the Risks of a "Non-Binding Agreement to Negotiate"

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Since 1978, Canadian courts have recognized an implied obligation on the parties to a contract to act in good faith in carrying out the contractual terms, including unilateral conditions precedent to an agreement such as property inspections, lawyer approval of a contract and obtaining mortgage financing. The "good faith" obligation requires each party to exercise his/her rights under the agreement "honestly, fairly and in good faith".

However, what happens in the case of pre-contractual negotiations where no contract has been entered into yet? The general position is that Canadian courts have been very reluctant to recognize an implied duty of good faith during the bargaining. That position may have moved a little as a result of a decision of the Ontario Superior Court in July, 2011 in the Carttera case which did not expressly deal with a "good faith" obligation but did prevent a party from terminating a non-binding Letter of Intent.

In Carttera, the parties signed a letter of intent ("LOI") for the purchase of a hotel in Toronto and carried out negotiations for a formal purchase and sale agreement ("APS"). The LOI provided for negotiations in "good faith" to finalize the APS. Before signing the APS, the Seller received information indicating it could realize a higher price than under the LOI and tried to terminate the negotiations with the Buyer. The Buyer applied for a certificate of pending litigation to tie up the property and prevent a sale pending a trial of the Buyer's claim for specific performance i.e. completion of the sale on the terms of a finalized APS and essentially "signed" by virtue of email correspondence.

The LOI contained the material terms, such as price, deposit amounts, closing date, mortgage terms and other matters but also provided that it was "not contractual" (except for Confidentiality and Non-Solicitation of other offers during APS negotiations), and no binding agreement existed until the parties were satisfied with all terms and conditions and an APS "had been executed".

The Buyer argued that the APS terms had been settled though email correspondence and only the execution formalities remained. The Seller claimed no APS was executed as expressly required by the LOI for a binding agreement and that the Seller's emails expressly included boiler plate language that the email "was not a digital or electronic signature and could not be used to form a contract" and thus the Ontario Statute of Frauds (that provides for agreements for land to be in writing and signed by the parties) did not apply.

The Court found for the Buyer and granted the CPL pending a trial of the issues of whether an APS had been reached as evidenced by the emails communications and whether such communications amounted to a "signed contract". The trial is pending and it remains to be seen if the court will find an APS was settled and electronically signed and that specific performance of the deal should occur.

The Lessons: A number of important considerations are gleaned from this case when using an "non-binding" LOI:

(a) an LOI can create an "interest in lands" notice of which can be registered on title if a dispute arises between the parties about whether or not an APS has been settled or signed – that will tie up the Seller's property;

(b) email communications may be sufficient to create a "signed" agreement under the Ontario Statute of Frauds;

(c) a pre-contractual LOI may be subject to an implied "good faith" obligations that may prevent a party from "walking away" at any time should a better deal present itself;

(d) consider adding language to your "boiler plate" email form that it "is not a digital or electronic signature and cannot be used to form a contract notwithstanding anything to the contrary at law".

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