

Preliminary agreements - drafting tips

David Thomson, Andy Martin

15 May 2013

The [first article](#) in this series discussed the main types of preliminary agreements, including the pros and cons of investing time in signing a preliminary agreement. This second article sets out some drafting tips that will be useful when preparing and negotiating any preliminary agreement.

Avoid the balloon

When it comes to drafting preliminary agreements, the best advice is to not allow the agreement to balloon into a large legal document. Take care to avoid the negotiation becoming a full dress rehearsal for the drafting of the final agreement.

When too much of the detail starts to pile into the preliminary agreement, there will always be a risk of stalling on key points. Before you know it, the preliminary agreement contains too much information, cannot be finalised and signed, and you are instead into the 'main' negotiation for the deal. When this happens, the parties may find that they have inadvertently bypassed the preliminary agreement phase - and whatever key commercial terms one or both of them wanted to lock down have not been committed to, and may very well remain open for discussion. That may or may not be a good outcome.

The status of the document is key

One of the most important parts of the preliminary agreement is a section addressing the status of the document. Being clear about whether you are committing to legally binding obligations is most important, and there is really nothing to be gained for either party if the position is left unclear.

Whoever holds the pen on the drafting should aim to clearly capture and reflect the expectations of the contracting parties, and to avoid a situation arising where any future party (including a judge) is ever called upon to second guess unexpressed intentions.

Where the parties have stayed silent on the status of the document, trying to discern what was intended down the track can end up being a subjective exercise carried out by someone who was not involved at the time. The conduct of the parties both before and after the signing of a preliminary agreement can also confuse the position.

There's really no doubt that taking the time to spell out what is binding and what is not binding is a simple solution. If it ever came to enforcement via a court, the inclusion of clear evidence of an intention to contract would normally result in the court striving to give effect to the parties' intention, rather than taking a more neutral approach.

The Court of Appeal in *Electricity Corp of NZ Ltd v Fletcher Challenge Energy Ltd* said:

"The intention of the parties, as discerned by the Court, to be bound or not to be bound should be paramount. If the Court is satisfied that the parties intended to be bound, it will strive to find a means of giving effect to that intention by filling the gap."

It is always possible to have some aspects of a preliminary agreement binding, and some expressed to be not binding on the parties. Where you do intend to create binding obligations, remember that it is unhelpful to include statements which are incomplete expressions of an agreed position – for example where one part of an otherwise binding arrangement is recorded, but the parties also insert words like "not agreed" or "to be discussed" within that part of the agreement.

Where you intend to be bound by the preliminary agreement, take the time to consider for how long. There may be a risk of the parties failing to agree on detailed documentation, and it will usually pay to spell out the position as to the timetable for subsequent agreement, and to include a deadline and provision for the preliminary agreement to fall away to ensure that it does not stay on foot indefinitely.

Drafting preliminary agreements

The reality is that every preliminary agreement is different. These documents really do need to be tailored to meet the needs of the parties, and an off-the-shelf approach is unlikely to be workable. However, there are some common threads, and if you keep the drafting clear and concise, the agreements are generally not time consuming to prepare.

The usual essentials include:

- **Parties:** A clear expression of which parties (two or more) are signing the preliminary agreement, with appropriate signature blocks
- **Consideration:** Details of consideration passing, which is often a mutual exchange of promises, sometimes with a passing of monetary consideration
- **Status and legal effect:** An upfront provision setting out the status of the document, and clearly stating which provisions (if any) are binding on the parties
- **Non-binding terms:** Where the preliminary agreement provides non-binding terms, a clear statement to that effect to avoid any doubt
- **Inclusion of key binding agreed provisions:** A clear expression of key commercial terms that have been agreed between the parties for inclusion
- **Agreed process and timetable:** This can be useful to keep the parties on track, particularly where there are certain milestones to reach along the way before a final deal can be done
- **Exclusivity:** Sometimes, exclusivity provisions to limit the rights of either or both parties to negotiate or transact with other parties during a defined period
- **Confidentiality:** Restrictions or protections for the parties, tailored to protect any or all parties depending on how information is flowing, and whether the preliminary agreement itself contains confidential matters (which it often will)
- **Intellectual property:** Provisions tailored to reflect any agreed arrangements in relation to intellectual property that may be exchanged or created by the parties during the period following the signing of the preliminary agreement
- **Termination:** A clear expression of when and how the preliminary agreement can be ended, and the consequences of such termination
- **Costs:** A simple statement recording how costs are to be shared or otherwise funded by either or both parties
- **Governing law and jurisdiction:** Along with other boiler plate clauses, the governing law and jurisdiction clauses should be included, particularly where the preliminary agreement records binding arrangements.

Please see part three of this series (available later this month) for discussion on the use of preliminary agreements in the context of consortiums participating in competitive bid processes.

Auckland

PwC Tower
188 Quay Street
Auckland 1010

PO Box 1433
Auckland 1140
New Zealand

P: +64 9 358 2555
F: +64 9 358 2055

Wellington

Aon Centre
1 Willis Street
Wellington 6011

PO Box 2694
Wellington 6140
New Zealand

P: +64 4 499 4242
F: +64 4 499 4141

Christchurch

83 Victoria Street
Christchurch 8013

PO Box 322
Christchurch 8140
New Zealand

P: +64 3 379 1747
F: +64 3 379 5659