PRELIMINARY AGREEMENTS

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1. INTRODUCTION – WHAT IS A PRELIMINARY AGREEMENT?

1.1 Common Forms

It is common practice in the Canadian mining industry that two or more parties contemplating the creation of a commercial relationship between them in respect of a mining project will, as a first step, execute a preliminary agreement. Preliminary agreements take a variety of forms.

The forms of preliminary agreement commonly used within the Canadian mining industry include:

(1) the letter of intent (LOI);

(2) the memorandum of understanding (MOU);

(3) the term sheet; and

(4) the expression of interest (EOI).

(Other English speaking jurisdictions sometimes use the expression "Heads of Agreement", but that is not commonly used in Canada). There is no established practice as to what form of preliminary agreement a party should use in any particular circumstances. It is however possible to identify some fairly common uses of preliminary agreements in the Canadian mining industry.

Parties will often use an LOI or an MOU where they have agreed on some of the items or terms that will govern their commercial relationship, particularly those that are of significance. For example, an LOI or an MOU contemplating an option to earn an interest in a mineral property will usually specify, among other things, any required due diligence and disclosure, the mineral property which is the subject of the option, the expenditure, cash payments or other consideration to be made or given by the party earning an interest in the mineral property, the term of the option and conditions for exercise, the extent of the interest to be earned and the legal structure that is to govern the relationship of the parties if the option is exercised.

Parties will often use a term sheet if they desire to specify in considerable detail, but truncated form, the terms that will govern their commercial relationship but, for some commercial or legal reason, do not wish to prepare and execute a definitive agreement at that time. The term sheet is sometimes used where parties are attempting to identify in summary form the points of agreement and difference between them.

The EOI tends to be used where a party indicates to another its general desire to pursue an opportunity. For example, a party who is conducting an auction process of mineral

rights or properties may, in order to identify investors or potential strategic partners, solicit expressions of interest by calling for the submission of an EOI.

1.2 Preliminary Agreements

Irrespective of the form it takes, generally a preliminary agreement is a short informal written document that records an understanding between two or more parties. In particular, the preliminary agreement usually records the indicative terms that are of most importance to the parties and contemplates the negotiation, preparation and execution of a subsequent definitive agreement between those parties that incorporates, among others, those most important indicative terms.

Commonly a preliminary agreement is not intended to bind the parties to it but its purpose is to provide a framework for subsequent negotiations between the parties with the expectation that definitive binding agreement between them will be created at some time in the future.

2. BINDING PRELIMINARY AGREEMENT OR AGREEMENT TO AGREE?

2.1 The Binding Preliminary Agreement

Before executing a preliminary agreement a critical (and often the most important) decision to be made by a party is whether the preliminary agreement is to be immediately binding on the parties to it or whether it is simply to be a document that contemplates the execution by the parties of a binding definitive agreement at some future time i.e. an *agreement to agree*. The failure of a party to clearly articulate in a preliminary agreement whether or not the preliminary agreement is to be binding can result in that issue being determined by a Court with adverse commercial consequences for that party[1]. As is discussed in greater detail below, in order to obtain both flexibility and certainty it is recommended that a hybrid form of preliminary agreement be used wherever possible.

Why then enter into a binding preliminary agreement or, as it is often called, a letter agreement? Common reasons for entering into a binding preliminary agreement usually relate to commercial rather than legal considerations and include:

(1) a party simply desires a binding commitment from the other party;

(2) unequal bargaining strength between the parties with the stronger party demanding a binding commitment from the other party;

(3) timing restraints;

(4) a mineral property has significant geological potential and the party who is seeking to obtain an interest in it desires to lock it up;

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[1] For example, *Green v. Ainsmore* (1951) 3 D.L.R. 632 (B.C.S.C.) where the vendor of a mine failed to prove that a LOI contained a binding agreement.

(5) doubt concerning, or distrust of, the other party.

As a general observation, binding preliminary agreements' are often prepared and executed in short time frames and without the benefit of any significant due diligence being undertaken by a party in respect of a mining project. As a result binding preliminary agreements commonly, if not invariably, contain terms that are less extensive and complete than would have been the case had a definitive formal agreement been negotiated and prepared. Often the end result is some uncertainty. If a party is prepared to execute a binding preliminary agreement then it must satisfy itself that it can live with the terms as struck. While sometimes there is an opportunity to revisit the terms if the parties subsequently endeavour to record the terms in a further formal agreement, there is no guarantee that a party will subsequently be able to incorporate within that formal agreement its desired additional terms.

2.2 General Principles – Requirements for a Binding Preliminary Agreement

As noted above, as a consequence of the circumstances in which binding preliminary agreements are often created, the terms within them are sometimes limited or incomplete. As such, although a preliminary agreement may purport to be binding, its terms may give rise to uncertainty as to whether a binding agreement has been made between the parties, especially if the preliminary agreement contains general or uncertain terms, fails to address or include all material terms or contemplates further negotiations in respect of any material matters.

In addition, during negotiation of a preliminary agreement parties often recognise that it is desirable that the terms of the preliminary agreement be subsequently recorded in a further formal document. As a result, preliminary agreements commonly contain a provision which contemplates the execution of a further formal document. The Supreme Court of Canada has specified how the Courts should construe preliminary agreements which contain provisions of this type when being asked to determine whether or not a binding agreement has been made by the parties:

It appears to be well settled by the authorities that if the documents or letters relied on as constituting a contract contemplate the execution of a further contract between the parties, it is a question of construction whether the execution of a further contract is a condition or term of the bargain, or whether it is a mere expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through. In the former case there is no enforceable contract either because the condition is unfulfilled or because the law does not recognise a contract to enter into a contract. In the latter case there is a binding contract and the reference to the more formal document may be ignored[2].

The issue of whether a preliminary agreement creates a binding agreement between the parties to it often comes sharply into focus when the parties attempt to prepare the further formal document, especially if the parties are unable to agree the terms of the further

[2] *Calvan Consolidated Oil & Gas v. Manning* [1959] S.C.R. 253 at 261

formal document. If there is to be a dispute over whether a preliminary agreement is binding, then it is usually at that point that a party may contend that the preliminary agreement did not contain all essential terms necessary for an agreement or that any agreement between the parties was conditional upon agreement by the parties as to the terms of the further formal document.

Whether a preliminary agreement is a binding agreement that can be enforced will depend on the parties' intentions. A preliminary agreement can only be enforced as a binding agreement if the parties intended to be bound by its terms[3].

The test for intention to create a binding agreement is an objective one and is to be ascertained by what an objective observer could discern from the parties' conduct[4]. In determining the parties' intentions, the Courts have had regard to one or more of the following matters:

(1) whether the parties have agreed to all of the essential terms - this will be critical and if any essential term is absent, the preliminary agreement will not constitute an enforceable agreement[5];

(2) the certainty or clarity of the terms in the preliminary agreement, in particular whether the preliminary agreement is too general or uncertain to be valid in itself and is dependant on the making of a formal contract. In these circumstances a Court may determine that a preliminary agreement is unenforceable even if the parties had intended to be bound by the preliminary agreement[6];

(3) conduct of the parties, particularly conduct subsequent to the execution of the preliminary agreement[7];

(4) the importance or emphasis placed on a formal written agreement by the parties[8];

(5) whether the preliminary agreement expressly states that it is binding and enforceable or whether the preliminary agreement contains a condition that makes clear that any agreement is subject to the approval and execution of a formal agreement[9].

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[3] *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.* (1991) 79 D.L.R. (4th) 97 (Ont. C.A.)

[4] *Osorio v. Cardona* (1994) 15 D.L.R. (4th) 619

[5] *Bawitko*, pp. 103-104. See also *Beacock v. Wetter* 2006 BCSC 951 at para. 41 and *Zynik Capital Corporation v. Faris* 2007 BCSC 527 at para. 69.

[6] For example, see *Cohoon v. Freeway Transport (1974) Ltd*. (1990) 48 B.L.R. 233

[7] For example, see *Rademaker, MacDougall and Co. v. Number Ten Holdings Ltd*. (1993) 47 B.C.L.R. 376 and *Canlan Investment Corp. v. Gettling* (1998) 36 B.L.R. (2d) 117 (B.C.C.A.)

[8] *Abode Properties Ltd. v. Schickedanz Bros. Ltd.* 1999 ABQB 902

[9] *Bawitko*, pp. 103-104

2.3 Drafting Considerations – Binding Preliminary Agreements

If a party intends that a preliminary agreement is to be binding, then the party should ensure that:

(1) the preliminary agreement expressly states that it is a binding and enforceable agreement. If the parties do intend for the preliminary agreement to be subsequently recorded in a formal agreement then to remove any doubt as to the parties' intentions, the preliminary agreement should state that it is binding irrespective of whether or not the parties subsequently execute a formal agreement;

(2) the preliminary agreement contains all of the essential terms that are necessary for the type of agreement being contemplated by the parties. For example, if parties execute a binding preliminary agreement in which one party agrees to sell a mineral property to the other party and the price is not specified but is said to be the subject of further negotiation or agreement, there is a significant risk that a court would find that the preliminary agreement was not binding but an agreement to agree;

(3) it and its representatives act consistently with the terms of the preliminary agreement. In particular, any public communications made by a party (press releases and the like) should be consistent with the notion that a binding preliminary agreement has been executed e.g. use of terms "binding letter of intent" is confusing and perhaps misleading; and

(4) the language used in the preliminary agreement should be clear and certain and should be expressed in language which is consistent with that of a binding agreement, i.e. a party must or shall perform a particular act or thing.

2.4 Common Pitfalls

There are some pitfalls associated with entering into a binding preliminary agreement without the benefit of due diligence and the negotiation and preparation of a definitive agreement. The following list is not exhaustive but represents some of the issues that can arise:

(1) Lack of Due Diligence – where a party has not conducted due diligence or only limited due diligence, this can result in a party failing to acquire all rights that are necessary for a mining project or structuring a contractual relationship in respect of the mining project in a manner that subsequently proves to be commercially disadvantageous. Two reasonably common examples follow.

In some jurisdictions, particularly civil law jurisdictions, there is a division between under-surface rights and surface rights. In these jurisdictions, under-surface rights are commonly held by the holder of the mining claim or mining licence but the surface rights are held by the land owner or some other third party. This may result in the party who is earning an interest in the mineral property

being forced into negotiations for access with a land owner or other holder of surface rights in which it has little or no leverage but where it has already paid or given consideration for an interest in the under-surface rights. If a party has any doubt about whether or not it is acquiring all necessary rights to explore a property, it should include a covenant in the preliminary agreement to the effect that any rights or interest being acquired by a party in a mineral property from the other party will include all rights or powers necessary in order to access the mineral property and to conduct exploration and mining operations on the mineral property.

In some foreign jurisdictions, applicable law requires that title to any mineral property be held by a company incorporated within that jurisdiction. Applicable law may also require that any exploration and mining operations also be carried out only by a company incorporated within that jurisdiction. As a result of time constraints or a failure to give consideration to the issue, a party may not enter into a binding preliminary agreement through a wholly owned subsidiary in the applicable jurisdiction but will enter into the preliminary agreement itself. Apart from causing difficulty in compliance with local applicable law, a party is directly exposed to the risks associated with operating in that jurisdiction. In addition, such an arrangement may ultimately have unintended adverse taxation consequences or if the parties subsequently attempt to restructure their contractual arrangements, the restructuring may be expensive or difficult to implement (e.g. dilatory governments departments or ministers) or give rise to unintended risks (e.g. loss of title).

If a party has not been able to determine in the time available whether the structure or arrangement contemplated (either presently or at some time in the future) in the binding preliminary agreement is suitable or desirable, it should include a covenant in the preliminary agreement to the effect that the parties agree to use reasonable commercial efforts to restructure their relationship to the mutual benefit of both parties if required by, among other things, applicable law, taxation considerations, or the prevailing commercial practices and policies of applicable governmental authorities.

(2) Lack of Certainty – as noted above, a common and largely unavoidable by-product of a binding preliminary agreement is uncertainty. Preliminary agreements by their very nature are often truncated and in an effort to achieve brevity sometimes make use of, but do not define, common mining terms or concepts that are capable of bearing multiple meanings. Wherever possible a party should define important terms or concepts to limit any uncertainty or ambiguity in a binding preliminary agreement.

The issue of certainty almost invariably arises when a binding preliminary agreement contemplates that after a party has earned an interest in a mineral property the parties will thereafter enter into a joint venture[10]. At the time that a

[10] This issue also bedevils formal option and earn-in agreements.

preliminary agreement is being entered into, exploration of a mineral property is usually early stage and the value of any potential resource is speculative at best. A party who is prepared to execute a binding preliminary agreement that is most likely far from definitive will rarely, if ever, be prepared to expend the required time and cost in negotiating a joint venture agreement which comprehensively documents a relationship that could conceivably subsist through the various stages of advanced exploration, project financing, development, construction, operation and closure. Parties sometimes attempt to address this issue by the inclusion of a provision that states that if the option is exercised then the parties agree that they will negotiate and enter into a joint venture agreement. While simple and convenient, this approach is flawed as agreements to agree are void and unenforceable[11]. To minimise the uncertainty that arises from a lack of agreed terms that will govern any future joint venture, one of the following approaches is commonly adopted:

(a) The best approach is to specifically reference a form of joint venture agreement that will apply and attach, as a schedule to the preliminary agreement, the form of the joint venture agreement together with an obligation to negotiate the definitive joint venture agreement in good faith. While the negotiation of comprehensive joint venture terms does require an investment of time and money, the risk of uncertainty is largely mitigated if the joint venture terms are sufficiently comprehensive. Self evidently, while this approach provides greater certainty it is not very practical and rarely, if ever, is adopted as it defeats the very purpose which a preliminary agreement attempts to achieve, that is, to conclude a binding agreement expeditiously and with limited effort;

(b) The second best approach is to attach a schedule of indicative terms of the joint venture agreement together with an obligation to negotiate the definitive joint venture agreement in good faith. It should be noted that while indicative joint venture terms alone may be sufficiently comprehensive to document an agreement on the essential terms, they will commonly fall short on the many subtle joint venture issues where more extensive negotiation and drafting is required. This approach is only as good as the term sheet of indicative terms that is used, which should be as comprehensive as possible. It is useful to incorporate by reference any appropriate provisions that may be fully articulated in the preliminary agreement, i.e. confidentiality, arbitration, etc. It is also recommended that the preliminary agreement provide that the agreement expressed by the indicative terms will constitute the joint venture agreement between the parties in the event that they are unable to successfully negotiate the definitive joint venture agreement.

[11] *Walford v. Miles* [1992] 2 A.C. 128

(c) The third but least desirable approach is for the parties to agree to negotiate and enter into a joint venture agreement "in industry standard form" with no indicative terms.

Although this is a simple inexpensive approach some significant risks arise out of its use. While joint venture agreements contain many standard terms there is no standard form of joint venture agreement used in the Canadian mining industry. Perhaps the only form of joint venture agreement that comes close to being something of an industry standard is the Rocky Mountain Mineral Law Foundation Model Form Exploration, Development and Mine Operating Agreement Form 5A. If a party decides to make reference to the Form 5A it should be recognized that the Form 5A was developed by US lawyers for use in connection with US properties and with reference to US property and tax laws and accordingly should be used with great care for parties or properties resident or situate outside the US.

In addition the "agreement" itself (i.e. to negotiate and enter into a joint venture agreement) would almost certainly constitute an unenforceable agreement to agree.

Selection of the appropriate approach requires an assessment, by an informed party, of the competing factors of risk, time and expense.

(3) Conditions Precedent for the Benefit of a Party – it is not uncommon for a party to insist on a preliminary agreement being a binding agreement yet also having an exit strategy. This is effective where the condition is a true condition precedent, i.e. dependant on acts or decisions of a third party however a party may be tempted to insert a condition precedent into the preliminary agreement in its favour which is highly discretionary. A common condition precedent of this type is as follows:

This agreement and the obligations of the parties under it are subject to Mining Co being satisfied in its absolute discretion with its due diligence review pursuant to section 5 of this preliminary agreement and having delivered a written notice to Property Co to that effect.

While a condition precedent of this type gives comfort to a party who is considering acquiring an interest in a mineral property, there is a risk that a court could find that the agreement in fact constitutes an option in favour of the party who has the benefit of the condition precedent[12]. As a general rule, for a court to enforce an agreement, one party must make payment to, or give some other form of consideration to the other party in exchange for the property or the benefits being given by the other party. If no consideration or insufficient consideration is

[12] *Griffen v. Martens* [1988] 27 B.C.L.R. (2d) 152 (B.C.C.A.), *Kitsilano Enterprises Ltd. v.G.&A.Developments* [1990] 48 B.C.L.R. (2d) 70

given, an agreement may not be enforced by a Court – in these circumstances there is said to be a failure or want of consideration.

In a formal document, lawyers routinely expressly state what the consideration is and have each party acknowledge and agree that the consideration provided is sufficient and adequate. In a preliminary agreement, particularly one drafted by the parties themselves without the benefit of counsel, the issue of consideration may not be addressed. As such, there is a risk that before the condition precedent is satisfied or waived, the other party could seek to withdraw from the agreement on the basis that it had not received adequate consideration[13]. To guard against a preliminary agreement being incapable of being enforced on this basis, a party should include a provision by which each party acknowledges and agrees that the preliminary agreement has been entered into for good and sufficient consideration which has been received. The consideration should also be specified – a nominal sum will be sufficient.

There is, on occasion, a tendency for a party having the benefit of a condition precedent to be somewhat cavalier in exercising the rights conferred on it by the condition precedent. If, for example, there is a tepid market reaction to the proposed mining project or significant shareholder expresses disapproval of it, a party may be inclined to use the condition precedent to attempt to easily exit from a binding preliminary agreement. Generally, the Court readily will imply a term into an agreement to the effect that a party must use reasonable efforts to satisfy a condition precedent[14]. A party who exits a binding preliminary agreement on the basis of a condition precedent not being satisfied should be able to demonstrate by written records what steps it took to attempt to satisfy the condition precedent. While most parties would be content to move on, from time to time a party will require that the party with the benefit of the condition precedent demonstrate what it has done to satisfy the condition precedent. If a party cannot ably demonstrate what it has done to satisfy the condition precedent, there is a risk that it could be subject to an action for breach of the agreement.

The party who does not have the benefit of a condition precedent should ensure that any condition precedent it agrees to is reasonable and will not allow it to be taken advantage of. For example, where an agreement is subject to approval of a party's board of directors it is a relatively simple thing for a party to elongate that process to suit its purposes. To prevent these types of abuses it is recommended that when a party agrees to a condition precedent a time limit is specified for satisfaction of the condition precedent failing which the agreement will automatically terminate.

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[13] *Mark 7 Development Ltd. v. Peace Holding Ltd.* [1991] 53 B.C.L.R. (2d) 217 (B.C.C.A).

[14] *Dynamic Transport v. O.K. Detailing Ltd.* [1978] 2 S.C.R. 1072

2.5 The Non-Binding Preliminary Agreement

As with binding preliminary agreements, common reasons for entering into a non-binding preliminary agreement usually relate to commercial rather than legal considerations and include:

(1) significant risk attaches to the mining project (politically, geologically or otherwise);

(2) no due diligence or insufficient opportunity to conduct adequate due diligence;

(3) insufficient funding;

(4) no prior dealings with other party.

The common and principal feature of the non-binding preliminary agreement is that the parties, without binding themselves to do so, "agree" to enter into some form of definitive agreement at a future time, that is, there is an *agreement to agree*. Self evidently, any party can withdraw at any time without adverse legal consequences and pursue other opportunities.

2.6 General Principles and Drafting Considerations – Non-Binding Preliminary Agreements

Agreements to agree are void and unenforceable. Agreements to negotiate are also generally unenforceable and are often considered agreements to agree. The reason why an agreement to negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty with the result that the Court has no means to police such an "agreement"[15].

If a party intends that a preliminary agreement is to be non-binding then the party should ensure that:

(1) the preliminary agreement expressly states that it is non-binding. A common clause of this type is as follows:

This LOI is not intended to be a binding agreement between the parties with respect to the subject matter of this LOI. A binding agreement will not occur unless and until the parties have negotiated, approved and executed the Definitive Agreement.

(2) the preliminary agreement includes a "subject to formal agreement" provision.

Care needs to be taken in the manner in which a clause of the above type is expressed, especially where the parties have agreed to all essential terms. For example, despite the existence of a clause in a preliminary agreement in the

[15] *Walford,* ,see also *Mannpar Enterprises v. Canada* [1999] B.C.J No. 850 (C.A.)

following terms – *"Subject To the Approval Of Mike Oliver Of Legal Documents Acting Reasonably"* the Court found that the parties were contractually bound. This finding was based on the fact that the parties had agreed to all the essential terms of the agreement, and that the formal written document was intended only to represent the agreement that had already been reached. Regarding the "subject to" clause the Court made the following comments:

As a matter of construction, I have no difficulty concluding, mainly from the clause requiring Mr. Oliver's approval "Of Legal Documents Acting Reasonably" that this clause cannot be read to give Mr. Oliver the authority to approve or disapprove an agreement already reached, if any. In other words, I conclude that if the communications are capable of creating legal relations, the "subject to" clause only means that Mr. Oliver, acting reasonably, could determine the language in which a formal instrument reflecting the bargain already struck would be stated.

In my judgment, the "subject to" clause in this case is a "a mere expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through[16]*".*

(3) the preliminary agreement should not use the language of a binding agreement – the use of terms and words such as "shall", "will", "agree", etc. should be avoided.

3. PARTIALLY BINDING PRELIMINARY AGREEMENTS

3.1 "Hybrid" Preliminary Agreements

Partially binding preliminary agreements (or "hybrids" as they are often called) are preliminary agreements that expressly specify which provisions bind and do not bind the parties. A hybrid agreement usually contemplates the negotiation and preparation of a definitive agreement at some time in the future and to assist in that process the most important indicative terms of a definitive agreement are specified in a hybrid preliminary agreement but these terms are usually non-binding. At a minimum, the provisions which are commonly binding are those relating to:

(1) exclusivity or "no shop" clause;

(2) confidentiality; and

(3) an obligation or agreement to negotiate a definitive agreement in good faith.

Prior to executing a hybrid preliminary agreement parties will often have previously executed a confidentiality agreement by which one party is given access to technical data or the mineral property and is permitted to conduct other due diligence. The party receiving technical data and who is granted access to a mineral property also commonly

[16] *LangleyLo-Cost Builders Ltd. v. 47835 B.C. Ltd* 2000 BCCA 365

agrees to a "standstill" provision. If the parties to a hybrid preliminary agreement have not previously executed a confidentiality agreement containing provisions of the type described above, then it is not uncommon for a due diligence provision and standstill provision to be included within a hybrid preliminary agreement and made binding between the parties.

If parties are unable to negotiate a definitive agreement at the outset of their commercial relationship, it is recommended that a hybrid preliminary agreement be used wherever possible. A hybrid preliminary agreement allows the parties to invest time and effort into the negotiation and preparation of a definitive agreement while conferring on each party some protection against unscrupulous behaviour by the other party.

3.2 Drafting Considerations –Partially Binding Preliminary Agreements

To be effective as a hybrid preliminary agreement it is essential that the hybrid preliminary agreement contain a provision that expressly specifies the provisions that are to be binding on the parties and those that are not to be binding. Without such provisions, a hybrid preliminary agreement will be susceptible to some of the issues regarding certainty and enforceability described above.

Other considerations include:

(1) Exclusivity – it is common for the parties to place a time limit on the period of exclusivity and to prohibit one of the parties, either directly or indirectly, from soliciting, initiating or entering into discussions or any form of agreement, arrangement or understanding for the sale or transfer of the mineral property during that period. Occasionally, the party with the benefit of an exclusivity provision will seek to include within the exclusivity provision a prohibition on the other party considering any offer, even those that are non-solicited. It is beyond the scope of this paper to analyse in any detail the consequences that could accrue to a party from agreeing to bind itself in that way however it should be noted that by agreeing to such a prohibition the directors of a party could be exposed to a claim that they have acted in breach of applicable fiduciary duty.

A party may also require that a break fee be paid to it if the other party breaches the exclusivity provision. Unless there is some commercial imperative that makes it desirable or necessary to insist on a break fee, such provisions should be avoided as they have a tendency to unduly extend the negotiation of a preliminary agreement.

(2) Good Faith – the obligation is usually simply expressed as follows:

The parties agree to proceed diligently and in good faith to negotiate the Definitive Agreement.

Generally, an obligation to act in good faith is commonly associated with notions of fairness, reasonableness and honesty. However, the simplicity ends there. While often there is a clear intention by both parties to act in good faith, what conduct actually does and does not constitute good faith is notoriously difficult to define or determine. This is because:

> *...the concept of a duty to care or negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to re-open the negotiations by offering him improved terms*[17].

As yet no Canadian court has decided that an express contractual obligation to act in good faith when negotiating a definitive agreement is enforceable. Why then have an express contractual obligation to negotiate in good faith? It is necessary because in the absence of a contractual obligation to do so, there is, as of yet, no general free-standing duty to negotiate or bargain in good faith in Canada[18].

Without a contractual obligation to negotiate in good faith a party could, in theory at least, sign a preliminary agreement and thereafter sit on its hands and refuse to negotiate. In addition there is an expectation that where a party is bound by an obligation to negotiate in good faith it will not thereafter act in a capricious manner or depart fundamentally from indicative terms set out in the preliminary agreement.

The Courts may be prepared to enforce an obligation to negotiate in good faith if there is clear standard against which to measure that conduct:

Where an agreement contemplates the negotiation of a subsequent agreement, it will not be enforceable except to the extent of requiring the parties to attempt to negotiate that further agreement in good faith. However, even that obligation will not be imposed where no objective criteria are set out in the initial agreement against which the negotiations can be judged.[19]

In reality it will be all but impossible for parties to specify an appropriate standard. If a party is concerned that a position which it desires to take could constitute a breach of the obligation to act in good faith it should expressly specify in the preliminary agreement that if it takes that position that conduct will not be taken to be bad faith.

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[17] *Walford*, pp. 138. See also *387903 BC Ltd. v. Canada Post Corp* (1995) 6 B.C.L.R. (3d) 370 (S.C.), at para. 63.

[18] *Martel Building Ltd. v. Canada* [2000] 2 S.C.R. 860 at para. 73.

[19] *Nuemann v. Smith* 2007 BCSC 1664.