

MCL3 Materials

Base Metals Pty Ltd v Precious Metals Pty Ltd

FACTS

Precious Metals Pty Ltd, an exploration company, is the registered owner of six mining tenements (the Tenements) in the north-eastern goldfields of Western Australia. It is mainly interested in gold and other precious metals.

Base Metals Pty Ltd, another exploration company, wished to explore the Tenements for base metals. It began negotiations with Precious Metals three years ago.

After discussions over a few months, Base Metals sent a fax to Precious Metals:

Subsequent to our conversation today, we propose the attached heads of agreement. This heads of agreement constitutes an agreement in itself, but is intended to be replaced by a fuller agreement not different in substance or intent.

Precious Metals replied by fax proposing terms of its own as “the basis for a formal agreement”. These included a proposal that Base Metals’ chief executive, Mr Wood, should undertake “to negotiate a formal agreement including the terms and conditions set out in this document”.

Base Metals replied with a fax which again attached heads of agreement. These were subsequently embodied in a letter (the Letter) which Mr Wood wrote to Mr Master, the chief executive of Precious Metals. The Letter was received, read and signed by Mr Master in April two years ago. It reads:

TENEMENTS EXPLORATION

I refer to our conversations today, regarding the above-mentioned project, and propose the following as a heads of agreement.

1. Base Metals will make three payments totalling \$250,000 to Precious Metals. The first payment of \$25,000 will be payable within 14 days of the execution of this heads of agreement, the second payment of \$100,000 will be payable on a date which is nine months from the date of execution of this heads of agreement, and the final payment of \$125,000 will be payable on a date which is eighteen months from the date of execution of this heads of agreement.
2. Base Metals will spend \$500,000 over three years on exploration within the Tenements, to earn a 100% interest in any base metals discovered on the Tenements, subject to item 3, below. Base Metals will further agree to provide Precious Metals with copies of all exploration results, including any aerial photography and aeromagnetics acquired by Base Metals.
3. Precious Metals will retain a 1% Gross Royalty on revenue derived from any base metals produced from the Tenements, and this royalty will be capped at \$10 million.
4. Precious Metals will retain a 100% interest in any precious metals discovered within the Tenements.
5. In the event that either of the parties identify an area within the Tenements capable of sustaining a commercial mining operation for both precious and

base metals then the priority of such a development will be determined by the mineral with the greatest recoverable value. The party with rights to first mine and treat such ore will undertake to treat the ore as a discrete batch and to store residues in a separate tailings compound.

6. The above forms a heads of agreement which constitutes an agreement in itself intended to be replaced by a fuller agreement not different in substance or form. On return of this signed agreement Base Metals will proceed to a fuller agreement.

Kind regards

(Signed) Andrew Wood

Chief Executive

I, David Master, for and on behalf of Precious Metals, do hereby agree to accept the terms and conditions set out above.

(Signed) David Master

Base Metals paid \$25,000 to Precious Metals as required by clause 1. It commenced exploration for base minerals in the Tenements.

Four months later Base Metals and Precious Metals agreed to amend clause 1 so as to make the sums of \$100,000 and \$125,000 payable nine and eighteen months respectively from the date of execution of a full agreement, rather than from date on which the Letter was signed.

Over the next nine months, Base Metals and Precious Metals conducted negotiations towards the “fuller agreement” contemplated by the Letter. Drafts were prepared. These dealt with various topics, including the possibility of transferring title in the Tenements to Base Metals, responsibility for compliance with the Mining Act, procedures where one party’s rights infringed on the other’s, steps to be taken before mining, rights to pass and re-pass over the Tenements, payment of royalties, and the resolution of disputes.

Differences emerged between the parties on a number of points: title to the Tenements, control over exploration, responsibility for statutory expenditures, responsibility for responding to native title claims.

After nine months Precious Metals was acquired by a foreign company. Negotiations with Base Metals were taken over by a new executive, Mr Bishop. They continued for a further six months. During this period Base Metals expended \$120,000 on exploration work in the Tenements, revealing the existence of potentially large deposits of the base metals nickel and cobalt.

At this point, Precious Metals advised Base Metals that, as the disagreements between the parties on native title claims and statutory compliance had not been resolved, Precious Metals could no longer allow Base Metals to engage in exploration activities in the Tenements. (In fact, the parties had not resolved their other differences either.)

Base Metals responded: "There is a Heads of Agreement which is legally binding and in operational effect." Precious Metals replied: "There is no concluded agreement."

Base Metals sued for a declaration that the Letter constitutes a binding contract.

In cross-examination at the trial Mr Wood was asked about the proposed fuller agreement referred to in clause 6:

Was that provision inserted in the heads of agreement at your instance? Was that your idea? --- It is a paragraph which I'm aware is used for many, indeed most, heads of agreement.

Is it a clause which is used, from your experience, even in cases where the parties know that there is a lot yet more to be decided? --- It is certainly a clause which is employed when the parties know there is a lot of detail yet to be attended to.

Yes, and a lot of things yet to be agreed? --- The heads of agreement, I was to understand as a layman, binds the parties to the broad commercial parameters of an agreement.

And when you achieve what you see as being an agreement as to the broad commercial parameters, at that stage, in your experience, you put a clause such as this in and then there is negotiation on the terms of a fuller agreement? --- Always at this stage where a heads of agreement is settled one assumes that both parties will negotiate in good faith a fuller agreement.

The document does not make any reference, or provision for, title arrangements in the event that nickel was discovered in commercial quantities. Do you see that as something which you would have expected to be spelled out in the fuller agreement? --- That would be part of the detail to be spelt out in the fuller agreement.

Base Metals v Precious Metals

The Law (1)

Please accept the following as an authoritative statement of the only law applying to the case.

There is no binding contract unless the parties intend to create legally binding relations.

Whether parties intend to enter such relations is to be determined objectively, that is by reference to what a reasonable person would infer from their conduct.

Where parties have executed an instrument in writing but it is uncertain whether in so doing they intended to create legal relations, the court may have regard to all the relevant circumstances to determine, objectively, what the parties' intention was. The relevant circumstances may include prior negotiations and subsequent conduct. However, the evidence of the parties as to their subjective intent is not admissible.

There can be no binding contract unless its essential or critical terms have been agreed upon. Thus there is no binding contract where an essential or critical term is expressly left to be settled by future agreement of the parties.

A term is not regarded as essential because the court regards it as important. It is for the parties to decide what terms are important or unimportant. Of course, the more important the term is the less likely it is that the parties will have left it for future decision. But there is no legal obstacle to the parties agreeing to be bound now while deferring important matters to be agreed later.

A contract of which there can be more than one possible meaning is not therefore void for uncertainty. As long as it is capable of a meaning, it will bear that meaning which the court decides is proper. For a contract to be void for uncertainty, its language must be so obscure and so incapable of any definite or precise meaning that the court is unable to attribute to the parties any particular contractual intention.

In the search for intention, no narrow or pedantic approach is warranted, particularly in the case of commercial arrangements.

Where some terms are uncertain, or where terms which one would expect to be in a contract of the kind entered into are missing, inferences may be drawn that the parties lacked the requisite intention to contract. The more numerous and significant the areas in respect of which the parties have failed to reach agreement, the slower a court will be to conclude that they had the requisite contractual intention.

The question whether the parties intended to make a concluded contract and the question whether they have succeeded in doing so are distinct questions. Where the parties intend to make an immediately binding agreement, and believe they have done so, the courts will strive to uphold it despite the omission of terms or lack of clarity. However, this principle is not applicable where the issue is whether the parties intended to form a concluded bargain. That inquiry need not be approached with any predisposition in favour of upholding anything. The question is whether there is anything to uphold.

Where the parties contemplate the execution of a formal contract the case may belong to any one of four classes:

1. The parties may intend to be bound immediately and exclusively by the terms which they have agreed upon whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms.
2. The parties may intend to be immediately bound but propose to have the terms restated in a form which will be fuller or more precise but not different in effect. In this case there is a contract binding the parties to perform whether the contemplated formal document comes into existence or not, and to join (if they have so agreed) in executing the formal document.
3. The parties may intend to make performance of one or more terms conditional on the execution of a formal document. In this case there is a contract binding the parties to join in bringing the formal contract into existence and then to carry it into execution.
4. The parties may intend not to make a concluded bargain all unless and until they execute a formal contract.

It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract.

As a general rule, where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect.

Base Metals v Precious Metals

The Law (2)

Please accept the following as an authoritative statement of the only law applying to the case.

Article 5

A contract is made only when the parties intend legal obligations to arise.

Commentary to Article 5:

Articles which refer to intention must be read in conjunction with Article 26, which deals with rights arising from assumptions.

Article 7

There is no contract if a necessary term is missing, is too vague, or has been left to future agreement.

Commentary to Article 7:

A term is necessary if, without it, it is not possible to discern what benefit each party was intended to get from their promises. Article 7 must be read in conjunction with Article 10. If the intended benefit is clear, then missing detail can be supplied. The conjunction of Articles 7 and 10 makes it clear that the court should be ready to adopt a construction which preserves the intended benefit. No narrow or pedantic approach is warranted.

Article 10

The obligations of the parties are —

- to perform their promises exactly
- to do everything that conscience requires to ensure that each gets the benefit intended by their promises.

Article 26

A person who makes an assumption of any kind may require another person to act in accordance with that assumption to the extent that it would be unconscionable not to do so.

Commentary to Article 26:

This Article gives relief against unconscionable departure from any assumption, including —

- assumptions as to intention
- assumptions that a contractual right exists or will exist.

Article 27

A person may not assert a right or deny an obligation to the extent that it would be unconscionable to do so.

Commentary to Article 27:

Article 27 overrides every other article in the Code. It operates whenever the application of any other article would result in the unconscionable assertion of a right or denial of an obligation.

Unconscionable is used in the Code as meaning ‘offending against conscience’.

Whether something is unconscionable must necessarily be judged by reference to both the values of the wider community and to the accepted morality of the particular environment in which it occurs. This encompasses the moralities of commercial expectations and risk allocation. The particular facts of each case, including pre- and post-contractual events, must be taken into account.

Base Metals v Precious Metals

Facts classification

Glue

1. In cross-examination Mr Wood said: “The heads of agreement, I was to understand as a layman, binds the parties to the broad commercial parameters of an agreement.”
2. In cross-examination Mr Wood said: “Where a heads of agreement is settled one assumes that both parties will negotiate in good faith a fuller agreement.”
3. Precious Metals is mainly interested in gold and other precious metals.
4. Negotiations with Base Metals were taken over by a new executive of Precious Metals when it was acquired by a foreign company.
5. The base metals discovered were nickel and cobalt.

Broad Principles

1. Base Metals discovered potentially large deposits of base metals before Precious Metals stopped negotiating.
2. Base Metals expended \$120,000 on exploration work.
3. Clause 2 of the Heads of Agreement stated that Base Metals was to earn a 100% interest in any base metals discovered.
4. Clause 3 of the Heads of Agreement stated that Precious Metals would get a 1% gross royalty, capped at \$10 million, on base metal revenue.
5. Clause 5 of the Heads of Agreement stated that Precious Metals would retain a 100% interest in any precious metals discovered.

Detailed Rules

1. Clause 6 of the Heads of Agreement stated that it constituted an agreement in itself intended to be replaced by a fuller agreement not different in substance or form.
2. The words immediately above Mr Master’s signature were “I, David Master, for and on behalf of Precious Metals, do hereby agree to accept the terms and conditions set out above.”
3. Base Metals paid \$25,000 as required by clause 1 of the Heads of Agreement.
4. Differences emerged between the parties on title to the Tenements, control over exploration, responsibility for statutory expenditures, and responsibility for responding to native title claims.
5. Base Metals and Precious Metals agreed to amend clause 1 of the Heads of Agreement so as to make the sums of \$100,000 and \$125,000 payable nine and eighteen months respectively from the date of the full agreement, rather than from date of the Heads of Agreement.