CONDITIONAL LETTERS OF INTENT: ARE THEY BINDING?

by

YOLELWA SIKUNYANA

(**Student number 16342594**)

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Supervisor: Professor B. Kuschke

Department: Private Law

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TABLE OF CONTENTS **PAGE**

KEY TERMS

BBBEE: Broad-Based Black Economic Empowerment
LOI: Letter of intent
PAIA: Promotion of Access to Information Act 2 of 2000
PAJA: Promotion of Administrative Justice Act 3 of 2000
PFMA: Public Finance Management Act
PPPFA: Preferential Procurement Policy Framework Regulations
PPPFA: Preferential Procurement Policy Framework Act
RFP: Request for Proposal
RFQ: Request for Quotation
RFT: Request for Tender

Chapter 1

INTRODUCTION

1.1. Background and rationale for study

A letter of intent (LOI) is usually a written document issued when a bidder has been selected as a preferred bidder to inform them of the intention of the other party to continue to negotiate and conclude a contract with them.
It is different from the letter of award which is issued only if there are no further outstanding matters to be negotiated. It is issued to inform the successful bidder unequivocally that they have been awarded the tender following an acceptance of their offer.

Finsen defines a letter of intent as a statement by the other party that they might [not will] accept the tender at some future date. He further asserts that a letter of intent is not legally binding.[1] This will however be explored and evaluated in this study.

In the United Kingdom for example, letters of intent (Hereinafter referred to as LOIs) have been identified as "similar to written agreements as they contain provisions that are binding, such as covenants to negotiate in good faith or non-disclosure agreements. However, they are not usually binding on the parties in their entirety because they are expressed as subject to a formal contract or any other condition envisaged in the contract to be concluded in the future."[2]

They can, however, be also identified as proposals for partial, incomplete or provisional agreements or agreements to negotiate.[3]

Often our courts are flooded with cases relating to disputes, where one party believes that a valid and enforceable contractual relationship based on an LOI issued to them exists, whilst

[1] Finsen V The Building Contract (A commentary on the JBCC Agreements) 2nd ed Juta 56.
[2] Muller J" Is a letter of intent a binding contract?" http://www.franciswilksandjones.co.uk (date accessed 19-02-16).
[3] Christie RH the Law of Contract in South Africa 6th ed (2010) 37, 40.

the other wants to escape liability despite having issued an LOI. The interests of both parties require protection.

With the increasing number of contracts awarded through the bidding process and the fast-commercial sphere where agreements are initiated everyday through the issuing of the so-called LOIs, it is clear that legal clarity must be established with regards to the rights and obligations of parties created through the issue of such letters and the expectations regarding these types of preliminary agreements.

If a party is able to terminate their obligation without regard of the interest of the other, it will clearly lead to repudiation and the end of trust in the principles of contract law. This will have serious implications to companies and persons who rely on the principles of contract law to conduct their businesses. It will also affect the economy if members of the public can no longer trust the binding nature of contracts as a viable mechanism to conduct their businesses.

Section 22 of the Constitution[4] provides that "Every citizen has the right to choose their trade, occupation or profession freely. The practice of a trade, occupation or profession may be regulated by law." It is therefore critical that certainty of law be developed or improved to reflect the constitutional values.

According to a recent report called the Emerging Markets Opportunity Index: High Growth Economies released by Grant Thornton International; South Africa is ranked as the leading emerging economy in Africa which seeks to create economic activity that will support entrepreneurs and boost employment.[5]

It is also important that certainty of law be established in making a determination in this regard, alternatively to address gaps in legal principles that create obligations on parties to negotiate and conclude contracts as purported in the use of LOIs. The law must be interpreted in such a way that it brings a balance of responsibilities between the parties as imbalance may affect the party that has no resources to pursue the other.

[4] The Constitution of the Republic of South Africa, 1996.
[5] http//www.blog.mydreamcourse.co.za (date accessed 09-01-18).

Christie states that among other things, "one of the aims of contract law is to promote legal and commercial certainty by providing a framework within which persons can safely transact and conduct business, secure in the knowledge that agreements seriously entered into will be enforced".[6]

South African courts have often been following an ununiformed approach with regards to the interpretation of the nature and extent of these LOIs. Accordingly, it would seem that the courts have not made any binding decision regarding LOIs. This indicates that a lot depends on the facts and circumstances of each case.

The study is therefore necessary to establish the extent of the gaps in the literature and case law and provide recommendations on how to deal with the gaps to establish legal certainty.

1.2. Problem statement

The study attempts to establish whether conditional letters of intent may serve as the basis for contractual liability in the law of contract in South Africa.

1.3. Proposed methodology

The study will entail synthesising literature in respect of the general principles pertaining to preliminary agreements in the law of contract; followed by an assessment of case law in South Africa and other jurisdictions. Following the initial examination, the study focuses on the historical approach, current legal position, various approaches adopted by our courts and challenges created as a result of these conflicting approaches.

The study will thereafter determine the major areas of disagreement or inconsistencies in the legal framework thereof by critically evaluating various case law, theories, arguments and findings in the context of determining contractual liability through preliminary agreements. Arguments relating the principle of isolation of offer to determine contractual liability,

[6] Christie 21.

consideration of good faith or not in negotiations and general requirements for a contract as opposed to a contract formulation based on offer and acceptance in preliminary agreements. The review will include for an example relevant books, articles, legislation, case law as well as electronic material obtained from various websites. In conclusion, the study will identify existing omissions and recommend solutions for the purposes of obtaining more legal clarity.

1.4. Delineations /Delimitations

The intention of the study is to focus on conditional letters of intent issued during a public procurement process (tenders). It will exclude private construction and lease agreements but will include some case law that addresses legal principles applicable to LOIs. The study will in addition investigate international cases and literature with regards to relevant legal principles relating to the research topic. To obtain a more conclusive result, the study aims to cover only the public-sector procurement.

Limitations may relate to the fact that contracts/ tenders are confidential in their nature and mostly subject to private arbitrations, therefore not reported and available in the public domain. Nationally, authority on the principles applicable to so-called 'pre-agreements' exists, but law relating specifically to tender processes is scant as the use of LOIs in this context is a more modern phenomenon.

Chapter 2

FORMATION OF CONTRACTS

2.1. Outline

The aim of this chapter is to give a brief historical overview and examine the influence of the Roman law and Roman- Dutch law on the modern South African law of obligations. Most of the Roman and Roman-Dutch law rules influenced the development of South African law of contract. It is therefore important to give attention to their origins and characteristics particularly in relation to the type of consensual contracts recognised as valid and binding, in order to provide better understanding of the general principles of the law of contract in South Africa today.

2.2. Contractual obligations in Roman law

The developed Roman law of contract was a law of discrete transactions: it lacked a fundamental unifying principle other than the necessity for an agreement.[7] Hutchison states that Roman Law had a law of contracts rather than a contract. It never developed a fully generalised theory of contract - one that regards any agreement meeting certain general requirements as an enforceable contract. [8]

The contracts were recognised in categories which were differentiated according to the source of obligation as follows:[9]

2.2.1. real contracts were created by agreement plus the delivery of the thing in question;
2.2.2. verbal contracts were created by the use of prescribed formal words to express a promise;
2.2.3. literal contracts were created by recording an agreed debt in a ledger; and
2.2.4. consensual contracts were created by mere agreement.

[7] Du Plessis P *Roman Law* 4th ed (2010) 253.
[8] Hutchison & Pretorius (eds) & Others *The Law of Contract in South Africa* 2nd ed (2012) 11.
[9] Du Plessis 252.

No agreement falling outside of these defined categories was recognised as a contract, no matter how seriously the parties intended it to be. This was because the fundamental principle was *ex nudo pacto non oritur action*: informal agreements or bare pacts, give rise to no action.[10] All contracts in Roman law were either *bona fidei* or *stricti iuris.*

Consensual contracts (sale, lease, partnership and mandate) were bilateral and *bona fidei*. Only they were an exception, in that mere agreement was sufficient to create a contract; and consent of the parties was sufficient.[11]

2.3. Contractual obligations in Roman-Dutch law

Our law of contract is essentially a modernised version of Roman-Dutch law of contract. This law recognised the canon law that, as a matter of the application of the good faith principle, all serious agreements ought to be enforced in accordance with the principle of *pacta sunt servanda.*[12]

2.4. The general requirements for a valid contract

Hutchison[13] describes a contract as an agreement entered into by two or more persons with the intention of creating a legal obligation or obligations. Emphasis here is on the fact that the agreement should be recognizable in the eyes of the law as well as binding to the parties involved.

For instance, under the English law, a contract is defined as an agreement that gives rise to obligations which are enforced or recognised by law.[14] This is similar to South African law of contract, however English law requires that three basic common law requirements be at least met, namely; agreement, contractual intention and consideration.[15]

[10] Du Plessis 252.
[11] Du Plessis 260.
[12] Hutchison 12.
[13] Hutchison 6.
[14] http//www.a4id.org "At a glance guide to basic principles of English law contract law" (date accessed 15-03-16).
[15] See footnote 14 above.

Cachalia describes government contract as a "bilateral transaction in which at least one party is the state, and the other, a private party".[16]

Even though these principles are mandatory for validity of contracts in general, letters of intent are based on the offer and acceptance principle and the general rule is that "agreements to agree" are not enforceable due to uncertainty.

Our law requires more than just consensus as discussed below.

2.4.1. Consensus- the minds of the parties must meet (or at least appear to meet) on all material aspects of their agreement. In order for a valid contract to come into existence, the parties thereto must reach consensus. That is, there must be a meeting of the minds regarding the conclusion of a legally binding agreement between them.[17]

2.4.2. Capacity- the parties must have the necessary capacity to contract. This means that parties must be able to understand the nature of a contract and the consequence of entering into a contract.[18]

2.4.3. Formalities – where the agreement is required to be in a certain form, these formalities must be observed. This principle was confirmed by the court in *Goldblatt v Freemantle*[19] where the court held that writing had been prescribed as a formality for the formation of the contract and found the contract to be invalid due to failure by the offeror to sign. The court did not invoke the doctrine of quasi-mutual assent even though the offeror had already started to supply the goods which formed the subject matter of the contract. In *Laws v Rutherford*[20] the court confirmed the principle that a prescribed method of compliance must be applied for a valid agreement to come into existence, and said it stood unless evidence is furnished to establish the waiver of the prescribed manner by the offeror.

2.4.4. Legality- the agreement must be lawful, which means it should not prohibited by statute or common law.[21]

[16]Cachalia R "Government Contracts in South Africa: Constructing the framework" Vol 133 Part 1:1 *Juta's Electronic Law Journa*l 234.
[17] Hutchison 5.
[18] Bhana D (eds) Student Guide to the law of contract 93.
[19] 1920 AD 123.
[20] 1924 AD 261.
[21] Hutchison 5.

2.4.5. Possibility- the obligations undertaken must be capable of performance when the agreement is entered into. At the time of the conclusion of a contract, it must be possible to render the required performance. If it is impossible to render one of the performances, then the contract is void from the beginning.[22]

2.4.6. Certainty- the agreement must have a definite or determinable content so that the obligations can be ascertained and enforced. In the case *of Premier, Free State v Firechem Free State (Pty) Ltd*[23] the court held at paragraph 35 that an agreement that parties will negotiate to conclude another agreement is not enforceable because of the absolute discretion vested in the parties to agree or disagree.

In order to attain consensus, the parties are required to communicate. These communications can be non-verbal, verbal or in writing. Unless the law prescribes formalities, contracts may be concluded informally. Communications during contractual negotiations fall in three broad categories, namely the initial negotiation phase that has no contractual consequences; the offer phase that has the potential for consensus, and the final acceptance of an offer which leads to consensus. These are dealt with in the discussions that follow.

2.5. The offer

"An offer is a declaration of intention by one party (the offeror) [bidder]) to another (the offeree) [the state]), indicating the performance that she or he is prepared to make, and the terms on which she or he will make it".[24] It can be made to a specific person, a group of people or even the general public.[25]

It must however be stated that when it comes to public tenders, the bidder prepares the offer in respect of the tender and it is not valid until it has been unconditionally accepted by the state.[26]

[22] Hutchison 5.
[23] 2000 (4) SA 413 (SCA).
[24] Hutchison 47.
[25] Hutchison 47.
[26] See requirements of a valid acceptance on this chapter below.

Internationally the leading case to set principles on offers to the public is the English case of *Carlill v Carbolic Smoke ball Co*1893] 1 QB 256,[27] where the Court of Appeal held that Carlill was entitled to a reward offered in an advertisement issued by the defendant company. It constituted an offer of a unilateral contract which she had accepted by performing the conditions stated in the offer.

There are four requirements for a valid offer:

2.5.1. The offer must be firm

The offer must be made with the intention that its acceptance will call into being a binding contract (*animo contrahendi*).[28] In the case *of Efroiken v Simon*[29] it was held that a firm offer is an offer upon which business can result at once and that as soon as it is accepted, there is a binding contract. Tentative statements will not suffice.

2.5.2. The offer must be complete

The offer must contain all the material terms of the proposed agreement, there cannot be further matters that still have to be negotiated before the overall agreement can take effect.[30] In a case where various issues have to be settled before the deal can go ahead, it is said that "nothing is agreed until everything is agreed".[31]

This concept was illustrated in the case of *CGEE Alsthom Equipments ET Enterprises Electriques, SA Division v GNK Sankey(Pty)*[32] where it was stated that in a case where various issues have to be settled before the deal can go ahead, it is said that "nothing is agreed until everything is agreed".[33] The court further held that "the existence of such outstanding matters does not, however, necessarily deprive an agreement of contractual force. The parties may well intend by their agreement to conclude a binding contract while agreeing either expressly or by implication, to leave the outstanding matters to future negotiation with a view to a comprehensive contract. In the event of agreement being reached on all

[27] http://www.e-lawresources.co.uk date accessed (16-05-16).
[28] *Pitout* p851
[29] 1921 CPD 367.
[30] *OK Bazaar v Bloch* 1929 WLD 37.
[31] *CGEE Alsthom* para34.
[32] 1987 (1) SA 81 (A).
[33] *CGEE Alsthom* para34.

outstanding matters, the comprehensive contract would incorporate and supersede the original agreement. If, however, the parties should fail to reach agreement on the outstanding matters, then the original contract would stand".[34]

The offer must be clear and certain

"The offer must be sufficiently certain, meaning it should be enough for the addressee to simply answer 'yes' for a contract to come into being".[35] The offer must not be too vague and there must be no doubt in the mind of the offeree of what is being offered. In cases where vagueness has been brought up, courts are reluctant not to enforce contracts that are intended to have a legal effect. Harms JA emphasised that "contracts are not concluded on the supposition that there will be litigation, and that the court should strive to uphold - and not destroy – bargains".[36]

2.5.3. The offer must be in plain and understandable language

The Consumer Protection Act (hereinafter the CPA)[37] came into effect on 1 April 2011. It introduces further requirements for offers in consumer contracts. Section 22[38] deals specifically with the right to information in plain and understandable language. The CPA stipulates that the producer of a notice, document or visual representation that is required, in terms of this Act or any other law to be produced, provided or displayed to a consumer must produce, provide or display that notice, document or visual representation in a prescribed form if any,[39] or in the form prescribed in terms of the Act or any other legislation, if any, for that notice, document or visual representation[40] in plain language if no form has been prescribed for that notice, document or visual representation.[41]

[34] *CGEE Alsthom* para34-35.
[35] Hutchison 48.
[36] *Namibian Minerals Corporations Ltd v Benguela Concessions Ltd* 1997 (2) SA 548 (A).
[37] 68 of 2008.
[38] Consumer Protection Act 68 of 2008.
[39] Sec 22(1).
[40] Sec 22(1)(a).
[41] Sec 22(1)(b).

2.6. The acceptance

"An acceptance is a clear and unambiguous declaration of intention by the offeree, unequivocally assenting to all the terms of the proposal embodied in the offer".[42] The acceptance will result in a contractual obligation between the offeror and the offeree; therefore, it has to meet certain requirements, namely:

2.6.1. The acceptance must be unqualified

"The acceptance must be a complete and unequivocal assent to every element of the offer; there can only be a valid acceptance where the whole offer and nothing more or less is accepted".[43] In the case of *Tactical Reaction Services v Beverley Estate II Homeowners Association*[44] the requirements of an acceptance were confirmed by the court. In the case of *Command Security Protection Services (Gauteng) (Pty) Ltd v South African Post Office Ltd*[45] the court held that the acceptance of a tender was not unconditional therefore it did not create a valid and legally binding contract. The acceptance must be by the person to whom the offer was made.[46] If the offeree in his response proposes some modification or condition to the offer, this will be regarded as a counter offer which the bidder must accept or reject.[47]

Unlike in offers to the public which can be accepted by any member of the public; an offer made to a specific person or persons may only be accepted by the specific person or such group of persons.[48]

2.6.2. The acceptance must be a conscious response to the offer

In the case of *Bloom v American Swiss Watch Co*[49] the court held that Bloom could not recover the reward offered because, until he knew of the offer he could not accept it, and until he accepted it there could be no contract. Further this reasoning was based on the principle of consensus between two minds as a requirement for the creation of a contract.

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[42] Hutchison 55.
[43] *Command* p14 of the judgement.
[44] Judgement CASE NO: 2007/16441, 6.
[45] (214/12) [2012] ZASCA 160 at 53,54.
[46] *Bloom v American Swiss Watch Co* p107.
[47] *Command* p14 of the judgement.
[48] See Hutchison 55 referring to *Bird v Summerville* 1961(3) SA (A).
[49] 1915 AD 100 p107.

2.6.3. The acceptance must be in the form prescribed by the offeror

The offeror is entitled to prescribe any method of acceptance they see fit; if the offeror does so, generally no other form of acceptance will suffice.[50] The court however took a different stance in the case of *Pillay v Shaik*[51] where it sparked controversy with regards to the application of the reliance theory. The court held that the reliance theory can be applied where acceptance does not take place in accordance with the prescribed mode of acceptance, but where the offeree leads the offeror to a reasonable belief that a prescribed form of acceptance has been in fact complied with. "Speaking generally, when the acceptance of an offer is conditioned to be made within a time or a manner prescribed by the offeror, then the prescribed time limit and manner should be adhered to".[52]

To conclude, consensus can only exist once an offer is made, and accepted, or in instances where the reliance created in the minds of the parties is that consensus was created. This was echoed in the case of *Sonap Petroleum v Pappadogianis*[53] where the court held that there was no consensus, actual or imputed. Therefore, no contract came into being as a result of the dissensus that existed between the parties.

2.7. Offers to the Public

It is important to give a generic discussion about offers to the public as calls for tenders fall under this category. Below is a brief description of other transactions that fall within this category.

2.7.1. Advertisements

One may ask whether an advertisement is an offer or just an invitation to do business. The general rule in our law is that advertisements are just invitations to do business rather than an offer.[54] To constitute an offer, a declaration of intention must set out the essential and material terms of the envisaged contract.

[50] *Laws v Rutherford* 1924 AD 261.
[51] 2009 (4) SA 74 (SCA).
[52] *Laws v Rutherford* p262.
[53] 1992 (3) SA 234 (A).
[54] *Crawley v Rex* 1909 TS 1105.

Even if the declaration sets out the detail of a proposed relationship with sufficient certainty, it will only constitute a valid offer if it was made with the intention that the offeree shall have the power to create a contract by accepting it.[55]

Although the case of *Crawley v Rex*[56] is the foundational authority on principle that advertisements are just invitations to do business; Hutchison warns that the determination of whether a statement constitutes an offer, will depend on what the intention behind the statement or the impression reasonably created by it in the mind of the person to whom it was directed to.[57] He confirms that this rule applies to any other offer statements that constitute an offer.

2.7.2. Promises of rewards

It happens often that a reward is offered to a member of the public who performs a certain act or gives certain information in response of a reward offered. The common question that arises is whether such a promise constitutes an offer to the public and whether a person who meets the conditions or performs the required act would be entitled to the reward. This was confirmed in the case of *Carlill v Carbolic Smoke ball Co1893] 1 QB 256*.[58]
In *Bloom v American Swiss Co*[59] the court held that the offer had not been accepted by the first person who supplied information to the police because he had at the time been unaware of the offer. In essence the reasoning of the court was that the person who accepts the offer must be consciously aware of the reward.

2.7.3. Calls for tenders

Even though tenders are offers to the public, they are not offers open to be accepted by the highest tenderer.[60] They are described as invitations to potential tenderers to make offers that will be considered after the closing date for that tender.[61] LOIs are issued after the offeror [bidder] submits its proposal through an [RFP, RFQ OR RFT]. The proposal itself must comply with the requirements of the offer and the acceptance and must be the mirror image of such an offer. If it is not a mirror image, the courts have held that such acceptance will fall and will be treated as a counter offer.[62]

[55] *Steyn v LSA Motors Ltd* 1994 (1) SA(A) para37-38.
[56] 1909 TS 1105.
[57]Hutchison 51.
[58] See under the offer discussion in para2.5 above.
[59] 1915 AD 100.
[60] Hutchison 52.
[61] Hutchison 52 and are also subject to Sec 217 of the Constitution.
[62]*Command* p14.

2.8. The Will and Reliance theories

Since a contract is not only created by offer and acceptance but, through consensus.[63] It is important to look at other requirements that may bring about consensus in respect of contracts formed through the offer and acceptance mechanism.

It critical to digest the principles of the Will [primary] theory and the Reliance [secondary] theory, particularly in respect of the LOIs.

2.8.1. The Will theory

The principle of the will theory is that the basis of the contract is to be found in the individual will.[64] It generally recognises the principle of freedom to contract and emphasises that parties are bound by their contract because they have chosen to be bound.[65]

According to the will theory the sole basis for contractual liability is consensus and without any concurrence of wills, it maintains that there can therefore be no contractual liability.[66] It requires actual subjective agreement between the parties for contractual liability to arise [subjective approach].[67]

Clearly this approach is not conducive for parties who rely on the principles of the law of contract to conduct their businesses and its sole application could be disastrous as it is non-flexible in its approach.

As the court stated in the case of *CGEE Alsthom Equipments*[68] the determination of whether a contract acquires contractual force or not depends upon the intention of the parties, which is to be gathered from their conduct in terms of the agreement and the surrounding circumstances.

Since the will theory postulates the view that if one party is mistaken about a material fact or equally does not read the contract properly then there is no binding contract.[69]

[63] Hutchison 46.
[64] Hutchison 15.
[65] Hutchison 15.
[66] Hutchison 15.
[67] Hutchison 81.
[68] 1987 (1) SA 81 (A) para2E.
[69] Hutchison 15.

This approach will also be contrary to the some of the presumptions applicable to interpretation of contracts.[70]

Since LOIs are also required to meet all the requirements of a valid contract, it is clear therefore that this theory cannot be suitable to determine if there is contractual liability flowing from an LOI as they follow the offer and acceptance mechanism which in its principle is evaluated beyond the consensus requirement.[71]

2.8.2. The Reliance theory

Also known as the doctrine of quasi-mutual assent. Although this theory acknowledges that the general principle for the formation of valid contract is consensus, it also determines that the basis of contract is found in the reasonable belief of the existence of consensus induced by the conduct of the other party.[72] The reliance theory is therefore seen as supplementary to the will theory; if the two parties have corresponding intentions consensus is present, and it is not a prerequisite to determine whether one of the parties had a specific idea of the intention of the other party.[73] If one of the parties erred regarding his intention or the intention of the other party and for that reason there's no consensus, the reliance theory states that if one of the parties reasonably relied on the idea that consensus was present, a contract is created.[74]

Since contractual obligation is founded on the parties' subjective intention it is often difficult for the one party to establish what goes on in the mind of the other. In such instances there should be a substitute basis for determining a party's liability.[75] Where there is dissensus which is not obvious, the party that acted contrary to the subjective consensus should be held bound to the apparent agreement.[76] Thus , contractual liability is found on reasonable reliance on the appearance of agreement or even a reasonable belief in the existence of a consensus that was induced by the other party.[77]

This theory contains two fundamental requirements namely that:

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[70] See chapter 5 para5.3 below.
[71] *CGEE Alsthom* para35.
[72] Hutchison 16.
[73] *South African Railway and Harbours v National Bank of South Africa* 1924 AD 704.
[74] *Pieters & Co v Salomon* 1911 AD 121.
[75] *Smith v Hughes* 1871 LR 6 QB 597.
[76] Thejane P "The Doctrine of Quasi Mutual Assent- Has it become the general rule for the formation of contract? The case of *Pillay v Shaik* 2009 4 SA 74 (SCA)" (2012 volume 15 no5) *Potchefstroom Electronic Law Journal* p4.
[77] *Spes Bona Bank Ltd v Portals Water Treatment South Africa (Pty) Ltd* 1983 (1) SA 978 (A).

2.8.2.1. The contract denier must have induced the reliance or belief of the contract asserter that the parties had reached consensus or that the contract denier had agreed to the contractual terms in question;[78]

2.8.2.2. The contract asserter's reliance must be reasonable in the circumstances.[79]

It is therefore critical to look at the application of the reliance theory in the context of conditional LOIs.

In order for a valid contract to come into existence, the parties thereto must reach consensus. That is, there must be a meeting of the minds as to material aspects of the agreement between them.[80]

Since consensus is achieved through a process of communication involving declaration of wills, the agreement may be expressed in any form. For instance, it can be expressed verbally, in writing or by conduct.[81] This principle is significant where LOIs are concerned as the method applied by the courts where agreements to agree are concerned has often been to isolate offer and acceptance in determining contractual liability. Having said this, it is my submission that the courts would still be required to investigate the intention of the parties, the terms of the contract and the surrounding circumstance to determine the existence of consensus. The case of *CGEE Alsthom*[82] demonstrates such principles. In public procurement particularly, the state may have an intention to use LOIs for commencement of work whilst the tenderer may interpret that commencement of work mean consensus has been reached. The discussion below qualifies the above statement.

An offer is an invitation by one person (the offeror) [tenderer] to another person (the offeree) [state] with the intention to create legally binding obligations between them. The question then arises whether an LOI is an offer, or whether it is merely something preceding an offer, or whether it is in fact an acceptance. An acceptance would then be the affirmative reply of

[78] *Hodgson Bros v South African Railways* 1928 CPD 257.
[79] *Steyn v LSA Motors Ltd* 1994 (1) SA 49 (A).
[80] Hutchison 13.
[81] *Pillay* para56.
[82] Para 2E, para34-35.

the offeree to the offeror's invitation with the intention to create legally binding obligations on the terms set out in the offer.[83]

Even in the context of LOIs the principle that acceptance must comply with certain requirements in order for it to be valid is supported as discussed above.[84] In short it must be made with *animus contrahendi* by the person to whom it was addressed (the offeree), it must also correspond with the exact terms of the offer, failing which it becomes a counter-offer and lastly, the acceptance must be communicated to the offeror. The communication of acceptance can take any form, except where the offeror has prescribed a particular method of acceptance[85] in which case the acceptance must be made in the prescribed manner in order for an agreement to come into existence.

In other chapters of this study, I have supported the argument that the state is not and cannot be treated as an ordinary contractant and since it is obliged to communicate with all bidders about the outcome of their bids; I submit that such communication ought to comply with the principles of Section 217 of the Constitution. Accordingly, once it issues an LOI it must therefore be specific enough in respect of intention to conclude a contract and since it contracts on behalf of the public.

In bringing the point home, LOIs must be discussed in the context of the two principles of the reliance theory mentioned in 2.8.1.1 and 2.8.1.2 above. The first requirement being that the contract denier must have induced the reliance or belief of the contract asserter that the parties had reached consensus or that the contract denier had agreed to the contractual terms in question. The contract denier would be the [state as an offeree] and the contract asserter would be [the tenderer as an offeror]. This presents some challenges under this principle. It has already been established that the invitation to tender from the state is not an offer, but an invitation for the public members to make offers to the state. When compliance to the offer requirements exists, then the question becomes: under which circumstances may the state induce the reliance or belief of the tenderer that they have reached consensus?

[83] *Command* and *CGEE Alsthom*.
[84] See para2.6 above.
[85] See chapter 3 below: in public procurement the state is required to communicate with all the bidders in writing. See also the Supply Chain National Treasury Guide for Accounting Officers.

In my view this could happen under two circumstances: one is where the state issues an LOI, depending on its content and compliance with the requirements of the offer it could be binding or not [this will be subject to the *Southernpor*t test].

The second instance is when the state issues an LOI and instructs the tenderer to commence with work whilst they negotiate a further contract [although the contents of such an LOI will also be subject to the *Southernport* principle, this is where there may be room for the reliance theory.

On the former scenario if the acceptance is qualified, then it will be regarded as a counter offer and therefore will not bring about a binding contract.[86] Further if it is subject to further conditions that pass the *Southernport* test then it could be accepted as a binding agreement to agree.[87]

On the latter scenario one will have to determine whether an instruction to commence with work could be said to have created the belief that the parties have reached consensus or not

Considering all the principles mentioned above the courts in the first scenario have made a clear precedent on the requirements of an agreement to agree, as such the conditional LOI will not attract contractual liability if it does not meet the *Southernport* threshold. In the event where the tenderer commences work after being appointed subject to conditions; this was dealt with in the case of *Command* where the court held that the conditional letter of appointment received by the appellant did not constitute an unconditional acceptance of its offer. However, it was intended by the respondent and accepted by the appellant as a counter-offer. The agreement that came into existence when it accepted the counter-offer was an agreement to negotiate.[88] Even though the Appellant in this case had commenced work, the court still maintained the position of *Southernport*.

In the case of *CGEE Alsthom*, the court emphasised that whether in a particular case the initial agreement acquires contractual force or not depends upon the intention of the parties, which

[86] Hutchison55.
[87] See *Southernport* regarding certainty para17.
[88] *Command* p14 of the judgement.

is to be gathered from their conduct, terms of the agreement and surrounding circumstances.[89]

Where the law denies such an agreement on contractual force it is because the evidence shows that the parties contemplated that consensus on the outstanding matters would have to be reached before a binding contract could come into existence.[90]

In my view the *Command* case is one where the court had an opportunity to apply the reliance theory. I do not agree with the approach taken by the court in reaching the conclusion that the only applicable mechanism to test contractual liability ought to have been based on offer and acceptance.[91] In this case the court followed a similar approach in determining the existence of the contract based on *CGEE Alsthom* case namely: the intention gathered from their conduct, the terms of the agreement and the surrounding circumstances. However, it differed significantly on its analysis regarding the conduct of the parties and the fact that the Appellant had already started to render the services, which was constructively addressed in the *CGEE Alsthom* case.[92] The court took a different approach in considering the discussion of the meetings held prior to the cancellation, where the Appellant alleged that a date in which he was to commence work had been confirmed.[93] The surrounding circumstances were not properly considered in my view; the court took the approach of isolating offer and acceptance and did not establish other forms to test consensus in order to determine contractual liability. I find in this case both the elements for the application of the reliance theory were present yet the opportunity to apply it was lost.[94]

In the case of *Pillay v Shaik*[95] the court extended the application of the reliance theory to the case where an acceptance of an offer does not take place in accordance with the prescribed mode of acceptance and where the offeree has led the offeror to the reasonable belief that the prescribed form of acceptance has in fact been complied with. The significant difference

[89] *CGEE Alsthom* p35, para2E.
[90] *Pitout* p 851B-C.
[91] *Command* para25 of the judgement.
[92] *CGEE Alsthom* p29.
[93] Trial court judgement [16945/2004] para39, 41-42.
[94] The state induced belief by allowing the appellant to commence work and presented a belief that the negotiations were purely to finalise outstanding matters at a later stage and it was reasonable for the appellant to believe that consensus was reached as they had started working and have had several meetings where certain critical dates were confirmed. Note 93 above.
[95] 2009 (4) SA 74 (SCA).

in this case is that the reliance was not so much in respect of consensus, but on the formal method of accepting an offer that has indeed taken place.[96]

The last requirement on the theory is that the contract asserter's reliance must be reasonable in the circumstances. The critical issue will be the method applicable in testing such reasonableness. The party who alleges a contract on the basis of quasi- mutual bears the onus of proving on a balance of probabilities the facts that warrant such a conclusion.[97]

This requirement has its support from a well-known *dictum* of Blackburn J in *Smith v Hughes*[98] namely: "If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon the belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the party's terms*".*

This is equally relevant to LOIs where the other party has been instructed to commence work pending the finalisation of a further contract or some other condition. The question would be such commencement of work has created a reasonable belief that consensus has been reached. If so, then the party who has created such an intention should be held liable in my view.

In the *Pillay* case[99] the court held that the key question to be asked was whether the party whose actual intention did not conform to the common intention expressed, lead the other party, as a reasonable man, to believe that his declared intention represented his actual intention.

To answer this question, a three-fold enquiry is usually, necessary. Firstly, was there a misrepresentation as to one party's intention; secondly, who made that representation; and thirdly, was the other party misled thereby?[100]

[96] *Pillay* para19-20.
[97] Hutchison 20, 97.
[98] (1871) LR 6 QB 597 p607.
[99] *Pillay* para55 of the judgement.
[100] *Pillay* para55 of the judgement.

It seems the court would be satisfied if the answers reveal that a party was actually misled as a reasonable man.[101] The reliance theory will therefore be applicable.

2.9. Is a conditional letter of intent a *pacta de contrahendo*?

When parties enter into a contract through a process of offer and acceptance, it is possible that before the offer is accepted, parties enter into an ancillary agreement concerning the main agreement that might follow.

*"*These ancillary agreements concerning offer to conclude another agreement are called *pacta de contrahendo* or "contracts about contracting".[102] Hutchison identifies that there are two types of contracts that our law recognises as binding *pacta de contrahendo* namely option and preference contracts.[103]

2.9.1. Option Contracts

An option agreement is an agreement to keep a substantive offer available for acceptance over a particular period of time. The agreement of irrevocability is binding on the parties for the particular period agreed upon.[104]

Hutchison emphasises that an option is a contract in its own right, therefore, it must meet all the requirements of a valid contract, including the consensus requirement.[105] As a letter of intent does not contain an offer that is by agreement made irrevocable, it is not an option. Therefore, the option structure is not relevant in this discussion on the nature of an LOI.

2.9.2. Preference Contracts

Hutchison explains that a preference contract is a supplementary agreement that involves one person (the grantor) binding himself or herself to give preference to another person (the grantee) should he or she decides to conclude another agreement (the main agreement).[106]

[101] *Pillay* para56 of the judgement.
[102] Hutchison 62.
[103] Hutchison 62.
[104] Hutchison 62.
[105] Hutchison 64.
[106] Hutchison 68.

The right of preference can be either to make a first offer (in a sale usually called a "pre-emptive right"), or the right of preference is to be the recipient or addressee of a first offer (in general often called a "right of first refusal").

In case where the substantive or main agreement; is a sale agreement; the ancillary preferential right agreement will often be referred to as a "pre-emption agreement".

An LOI could contain a right of preference in a future offer to be made or received, yet it usually relates to the award of a tender, or the acceptance of a preceding offer or tender. It is thus in this context that the LOI is analysed, without launching into a detailed discussion of preferential rights and the law that applies to their content and enforcement.

A conditional LOI is therefore not an option or a preference contract, but what Hutchison and Christie refer to as an agreement to negotiate in good faith, or an agreement to enter into a further contract.[107]

The circumstances in which an agreement to negotiate were settled by the Supreme Court of Appeal in the case of *Southernport.*[108] The court held that "the present case had to be distinguished from the *Firechem*[109] case because the parties had created a specific mechanism to ensure that an agreement was concluded. This was the dispute resolution mechanism of arbitration and provided that in the event of the parties not being able to agree on any of the terms and conditions, such dispute would be referred to an arbitrator".[110]

The court was echoing the same principle used in *Letaba Sawmills (Edms) Bpk v Majovi (Edms) Bpk*[111] where the parties agreed to enter into negotiations in good faith in order to agree upon the terms and conditions of the lease agreement and that if the parties were unable to reach an agreement on the terms and conditions then the agreement provided for the matter to be referred to arbitration. This was considered enforceable by the court.

In the light of the definitions given above, it would seem that, although LOIs may be "pacta *de contrahendo*", they are not options nor rights of preference. They seem to differ

[107] Hutchison 212 and Christie 37-40.
[108] 2005 2 SA 202 SCA para17.
[109] "An agreement that parties would negotiate to conclude another agreement is not enforceable, because the absolute discretion vested in the parties to agree or disagree" para35.
[110] *Southernport* para17 and para11.
[111] 1993(1) SA 768 (A).

significantly as they are based on an original offer made (the proposal) and an acceptance (the appointment letter). In respect of this principle, if the acceptance of the offer does not reflect a mirror image, it is therefore regarded as a counter offer in our law, therefore making a letter of intent different from both the above. Further if there is no provision for good faith, then there is no obligation to further finalise negotiations as the desire vests with parties.[112]

[112] See *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 (1) SA 256 (CC) in reference to good faith.

Chapter 3

TENDER PROCEDURES

3.1. Outline

This chapter will focus on the preliminary contractual stages and a discussion leading to the issuing of letters of intent. It aims to determine to what extent LOIs can be enforceable if they contain conditions that the relationship between the parties is subject to future negotiations on various matters. Specific focus will be directed to the effect of the regulatory and prescriptive nature of public tenders. This relates specifically to the material terms of LOIs at the time of issue, even if they are subject to a conclusion of a future agreement.

3.2. Calls for tenders

An invitation to the public to submit a tender for work to be done is not an offer that is open for acceptance by the highest tenderer. At most it is an invitation to potential tenderers to make offers that will be considered after the closing date set for that particular tender.[113] Internationally the construction regarding calls for tenders is similar. In his article, Carnie states that historically in New Zealand, a call for tenders was viewed as an invitation for information. A tender submitted by a bidder was considered to be no more than an offer which did not give rise to any legal obligations unless or until it was accepted by the principal.[114]

3.3. Competitive commercial bids processes

Tendering is a common process for business supplying goods and services to other businesses and public sector. Bolton describes procurement as generally the function of purchasing

[113] Hutchison 52.
[114] Carnie J. "Law of Tendering" http://www.clendons.co.nz published on 22 May 2014 (date accessed 8 April 2016).

goods and services from an outside body. It can also be viewed as a fair way to promote competition and fairness in the commercial space, especially in public procurement.[115]

Ordinarily competitive commercial bids may be sought under various procurement mechanisms that are common throughout the public and private sector procurement. An invitation for bids is issued identified in industry as *inter alia*: RFP, RFT and RFQ.

Since there may be various other terms that are used in the contracting processes such as calls for "expression of interest", but for the purposes of this paper, I will only discuss the above examples as they are common in public procurement. What is critical about the processes is the determination of whether parties have a serious intention to create contractual obligations by engaging in the process.

3.4. Overview of regulatory framework of public tenders

The principal piece of legislation that regulates public procurement is the Constitution. The Constitution provides that when organs of state procure goods or services, they must comply with five principles: fairness, equity, transparency, competitiveness and cost-effectiveness.[116] This clearly means that the duty rests on organs of state to spend public money effectively and having considered all the circumstances that will promote the five principles.

The Public Finance Management Act (PFMA)[117] is aligned with the provisions of the Constitution, as it particularly provides that an accounting authority for among others, a national or a provincial department or public entity must ensure that the particular department or entity has and maintains an appropriate and provisioning system which is fair, equitable, transparent, competitive and cost-effective.

The PFMA is implemented through the regulations[118] published under it which among other things provide for the procurement of goods and services through the sourcing of quotations

[115] Bolton P "The Legal Regulation of Government Procurement in South Africa" 2006 (9)2 Po*tchefstroom Electronic Journal.*
[116] Sec217(1).
[117] Public Finance Management Act 51 of 1999 Sec51(1) (a).
[118] National Treasury: Regulations for Departments, Trading Entities, Constitutional Institutions and Public Entities: Issued in terms of the Public Finance Management Act 1999, GG No 27388 of 15 March 2005.

or a bidding process. This must be done accordance with the threshold values as determined by the National Treasury.[119] These laws do not refer to any instrument specifically, and thus make no direct reference to LOIs.

The Preferential Procurement Policy Framework Act (PPPFA)[120] and the regulations published under it in 2011 (PPPFA Regulations) which have now been repealed and replaced by the 2017 PPPFA regulations[121] specifically prescribe requirements for Black Economic Empowerment considerations for state tenders.

Similar provisions are included in the Local Government: Municipal Finance Management Act (MFMA)[122] which provides that organs of state (falling within the ambit of the Act) must have and implement a supply chain management policy which is fair, equitable, transparent, competitive and cost-effective.[123] Once more the provisions contain broad values and are non-specific with regards to documentation.

The Minister regulates threshold values for procurement of goods and services, which he prescribes through practice notes from time to time,[124] and in the 2011 Regulations this was as follows:

(a) the 80/20 preference point system for the procurement of goods and services with a rand value of R1 million;[125]

(b) 90/10 preference point system for the procurement of goods and services with a rand value of above R1 million.[126]

As of 20 January 2017, the amended Preferential Procurement Regulations were gazetted by National Treasury.[127]

The key changes in respect to the functionality and scoring are as follows:

[119] See footnote 118 above Reg 16A6.1.
[120] Act 5 of 2000.
[121] 2017 Preferential Procurement Regulations effective from 1 April 2017.
[122] Act 56 of 2003.
[123] S 111 read with S 112(1).
[124] In terms of 76(4)(c) of the PFMA.
[125] 20 points are allocated to a bidder in respect of its B-BBEE status level.
[126] 10 points are allocated in respect of the bidder's B-BBEE status level.
[127] The effective date of the Regulations is 01 April 2017.

(a) The 80/20 preference point system is now applicable on acquisition of goods or services for Rand value equal to or above R30 000 and up to R50 million;[128]
(b) The 90/10 preference point system is now applicable for acquisition of goods or services with Rand value above R50 million;
(c) Maximum scoring is allocated for price (90/80) and Supplier B-BBEE status level counts for the remaining scores (10/20) respectively; subject to the amounts above.

The process of awarding happens after the evaluation and scoring. The state is required to inform all the bidders in writing regarding the outcome of their bids.[129] Particularly the state must issue a letter of award/ appointment to the successful bidder/s and may issue a letter of intent to preferred bidders in the event that there are outstanding matters to be finalised.[130]

A contract is defined in the PPPFA regulations[131] as an "agreement that results from the acceptance of tender by an organ of the state". To this extent, all these requirements create a serious intention to contract on the part of the state. The question remains whether the conditional letter of intent is in fact an acceptance that triggers consensus and thus creates a binding contractual obligation?

*"*There is no doubt that where in the course of negotiating a contract the parties reach an agreement by offer and acceptance, the fact that there are still a number of outstanding matters material to the contract upon which the parties have not yet agreed may well prevent the agreement from having contractual force".[132]

In my opinion the statement above is correct, however it needs to be qualified where agreements to agree are concerned. The answer lies in this twofold approach derived from Christie "especially in complicated or protracted negotiations it is not uncommon for the parties to record the progress they have made in a partial agreement, thus clearing the points on which they are agreed out of the way and facilitating discussion on the points that remain

[128] PPPFA Regulations 2017.
[129] See the Supply Chain Management Guide for accounting officers/ authorities issued by the National Treasury annually.
[130] *Command* para17, 35.
[131] Both the 2011 and 2017.
[132] *CGEE Alsthom* p34.

outstanding. If agreement is eventually reached on the outstanding points and a complete contract and signed, the prior partial agreement is usually forgotten, but if for one reason or another the intended contract is never concluded, one party will sometimes seek to hold the other to the partial agreement. Obviously, he cannot be permitted to do so, because although the partial agreement may have taken the form of an accepted offer it lacked *animo contrahendi*, being designed incomplete or provisional".[133]

In the context of LOIs the above analysis is critical as the condition/s contained in the LOI will have to be analysed under these principles. If the conclusion finds that the initial agreement is valid then it would have to comply with the principle set out in *Pitout,*[134] *CGEE Alsthom Equipments*[135] and *Southernport*[136] otherwise then it will have no contractual force as was held in *Firechem*.[137]

Christie confirms that the initial agreement cannot acquire contractual force if it's incapable of standing on its own. For an example he states that if it contains a condition precedent requiring a further agreement of the parties.[138]

In *Southernport* the court makes it clear as to under which circumstances a preliminary agreement will be enforceable. Firstly, where the parties have expressly agreed to engage in negotiations in good faith and have reached agreement on all material terms with negotiations merely intended to conclude secondary provisions within the minds of the contracting parties. The second requirement is that a dispute resolution mechanism is agreed upon and creates certainty, and that parties will refer a dispute to an independent arbitrator for a final and binding decision.[139]

In the light of the above it is clear then that conditional LOIs are subject to the above principles and also to the requirements of an acceptance, specifically that such acceptance [in a form of a conditional LOI] must meet the mirror image rule otherwise it is a counter-offer.[140]

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[133] Christie 37.
[134] See p851 in respect of consensus in agreements to agree.
[135] See p34-35 in respect of intention.
[136] See para17 in respect of certainty.
[137] 2000 (4) SA 413 (SCA) para35.
[138] Christie 39.
[139] *Southernpor*t para17 and *Letaba* p775.
[140] *Command* p14 of the judgement.

Chapter 4

THE NATURE OF A LETTER OF INTENT

4.1. Outline

Although there is no specific reference to the LOI in the public procurement legislation and regulations, an LOI can be described as a document that is usually issued when a bidder has been selected as a preferred bidder to inform them of the intention of the other party to continue to negotiate and conclude a contract with them. This in fact in nature is a *pactum de contrahendo*. In essence, such a *pactum* is void as one cannot bind oneself to contract in future due to the doctrine of freedom of contract.

4.2. What is the nature of an LOI?

Christie recognises that "in complicated negotiations, it is not uncommon for parties to record the progress they have made in a partial agreement; thus, clearing the points on which they have agreed on so that they can deliberate on the outstanding points not yet agreed to".[141]

What becomes critical to determine in the context of LOIs is the question of whether it was made with an intention to conclude a legally binding agreement (*animo contrahendi*). One may ask whether it is an acceptance or whether it was made on a provisional basis only, in that a conclusion of a binding agreement was to be dependent on agreement of the further outstanding points.[142]

Where an intention to be bound can be demonstrated, the courts for instance in Australia have increasingly shown willingness to "fill in the gaps" in preliminary agreements, so that the agreement may be enforced, provided that the missing terms are not so important or numerous as to make the agreement itself "incomplete".[143]

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[141] Christie 37.
[142] Christie 37.
[143] Lewis RG. and Cooper M "Liability for conduct in pre-contractual negotiations" http://www.nortonrosefullbright.com published on December 2013 (date accessed 12 February 2016).

Christie seems to favour the interpretation applied by the South African courts, specifically in the case of *Pitout v Northern Cape Livestock Co-op Ltd,*[144] which suggests an analysis which isolates the offer and ascertain whether the evidence shows that the offeree knew or ought to have known that the offer was intended to be accepted on a provisional basis only, and that a conclusion of a binding agreement was to be dependent on agreement of the further outstanding points.[145] This isolation approach was also followed in the case of *Command*.[146] The approach is consistent with the requirements of an offer and acceptance that requires a mirror image.[147]

Where the parties intend the key terms of the contract to remain open for negotiation, it is common for the preliminary agreements to be marked "subject to contract", and to include a provision that the parties will negotiate to attempt to reach a further agreement based on the preliminary one.

In the public procurement process, an LOI is usually issued when a bidder has complied with all the requirements of the tender and has been selected after an evaluation as the preferred bidder. The question remains whether this is a binding acceptance of the bid (the offer). The LOI is normally subject to conditions, such as the "conclusion of a final agreement", in which case it is clear that it merely confers preference but not yet binding rights and duties. It could also be issued subject to other conditions (in the public sector, conditions like the bidder's improvement of BEE status, changes to price or Local Content are common matters to be left open for further negotiation). However, prices can still be negotiated with all the preferred bidders where there is more than one, subject to obtaining permission from the Accounting Officer, provided that such negotiations will not prejudice any other bidder.[148]

Parties continue to have the discretion to break off negotiations at any time, which is why the uncertainty regarding the binding nature of preliminary agreements prevails.[149] However, in the case of *Indwe Aviation (Pty) Ltd v Petroleum Oil and Gas Corporation of South Africa*

[144] 1977 (4) SA 842 (A).
[145] Christie 37, *Pitout* p851.
[146] 214/12) [2012] ZASCA 160 p14.
[147] *Command* para25.
[148] PFMA Reg 4.1.2 Supply Chain Management: A Guide for Accounting Officers/ Authorities. [other bidders may exist where there is a split award [unsuccessful bidders are those that have received letters confirming that they were not successful].
[149] Hutchison 61,

(Pty) Ltd,[150] Blignault J held that "an agreement to negotiate a further agreement is in principle, binding because it imposes an implied duty on each party to act honestly and reasonably in conducting the negotiations and a court is able to determine whether a party has done this".[151]

Accordingly, it is clear that the intention of the parties is a critical factor in determining whether a preliminary agreement is a binding contract or merely an agreement to agree.

When it comes to public procurement, it seems that more effort is required from government to comply to a higher standard, one going beyond the minimum principles applicable in the general law of contract. Cachalia defines government commercial activities as constitutionally derived, therefore over and above the general requirements of contracts its transactions must comply with the Constitution together with any regulatory framework.[152]

Government contracts exist for specific purposes only, are limited in their scope by the statutes which give them validity and are unusually affected by considerations of public policy.[153]

In the case of *C Shell (Pty) Ltd v Oudtshoorn Municipality*[154] the court gave clarity regarding government contracts. It held that "the decision to award the contract constitutes administrative action and is governed by administrative law.[155] Additional obligations in public procurement, include that the state must act lawfully; act in the public interest promoting equality, fairness and dignity in its dealings.[156]

Ferreira sums it up as follows; "government as a contracting party is unlike a private contractant, unique in several respects: first, it contracts not to further its own interests, but the public interest generally; secondly, the government is possessed of public powers and functions that it is required to exercise in the public interest; and thirdly, it is usually in a more

[150] 2012 (6) SA 96 (WCC).
[151] *Indwe* para22, 27.
[152] Cachalia 97.
[153] Cachalia 234 para3.
[154] [2012] 3 All SA 527 (WCC).
[155] Para102-104 of the judgement.
[156] Para104-105 of the judgement.

powerful position *vis-à-vis* the party with whom it contracts than is ordinarily the case when only private parties contract".[157]

Ferreira's view point can be supported, the state cannot be treated as a normal contractant, since it is obliged to conduct its dealings under the compliance of Section 217 of the Constitution.[158]

Ferreira further correctly confirms that, where the government enters into a contract as a result of the exercise of a power granted expressly by statute, it must act within the confines of that power. This means first, that its conduct must fall within the parameters of the relevant empowering provision, and secondly, that any mandated preconditions or requirements of the exercise of the power must be complied with.[159]

This perhaps suggests that a letter of intent is issued to a bidder as a result of a completed regulatory process (tender evaluation), in order to indicate the state's intention to contract. The award should be subject to few (non-material) or no conditions at all to conclude another agreement.

This was also echoed by the court in the case of *De Vries Smuts v Department of Economic Development and Environmental Affairs*.[160] In brief the sate briefly advertised an invitation to the service providers to submit proposals, and Smuts (Plaintiff) was appointed. According to the plaintiff, the appointment marked the acceptance of the offer he made and thus constituted an agreement between the parties. The basis of the claim was the alleged repudiation of the agreement when the defendant, informed the plaintiff, via that there was no agreement concluded between the parties.

One of the arguments raised by the defendant was that the appointment of the plaintiff, even though it might be an acceptance of the offer made, does not and did not constitute a binding contract. For that the defendant relies on a condition in the tender documents which read that "the service provider shall enter into a binding service level agreement with the

[157]Ferreira C "The quest for clarity: An examination of the law governing public contracts" 2011 Vol 128 Part 1: 1 172 *South African Law Journal*.
[158] For instance, Preferential Procurement Policy Framework Act 5 of 2000 and its regulations and PAJA requirements.
[159] Ferreira 175.
[160] Unreported case [2010] ZAECBHC 8.

department." The defendant maintained that where there is no fulfilment of that condition i.e. the anticipated SLA has not been entered into, no contractual obligations could flow.

The court held that generally speaking, the acceptance of the tender by the contracting authority results in a binding contract coming into being. The SLA[161] condition only serves to protect the government in that it is able to force the supplier to enter into a subsequent agreement. In this respect the court evaluated the position of the state and was of the view that all material requirements of a contract had been met. This is critical for an LOI as it has to meet the requirements of a contract and once these are met, the contract will be enforceable subject to the principles outlined in the cases discussed above.

There is a school of thought that supports the idea that there should be no room or little room for the state to negotiate after the award.[162] It is indicated that such negotiation may not be fair to other bidders as it may amount to a variation of the initial terms of the tender.[163] One of the reasons an LOI is issued is to negotiate a further agreement. What is argued above is that such negotiations should be such that, they do not vary the initial terms of the tender. Practically negotiations post the acceptance of an offer by the state should be very limited.

Having said this, the prohibition of negotiations post award in government contracts have not been established, nor the compulsory application of Government General Conditions of Contract (GGCC) as mandatory for the conclusion of government agreements with no room to deviate from, amend or renegotiate them.[164]

In view of the above it is clear that what needs to be considered is whether LOIs in public procurement are binding or just agreement to agree as described in the case of *Premier, Free State*; or whether they are what the court refers to in the case of De *Vries*. Furthermore, if room for negotiations after the award in government contracts is limited as Bolton argues above: do LOIs then carry any conditions that can be legally enforced, or do they merely

[161] A Service Level Agreement is normally signed by the bidder after its appointment and after all the outstanding matters have been finalised.
[162] Bolton P *"*Scope for negotiating and/or varying the terms of government contracts * awarded by way of a tender process" 2006 Vol17/Part 2 *Stellenbosch Law Review* 267.
[163] Bolton P sub-para 5.1. See also the Guidelines for accounting officers in chapter 3 above in reference to fairness.
[164] Guidelines for Accounting Officers 267.

inform bidders that their offer has been favoured as potentially successful, yet will only be accepted on fulfilment of certain further conditions?

Case law has shown an inconsistent approach that has created uncertainty. Perhaps this indicates that no general rule is possible, and that all cases must be judged on their specific merits.

One particular case that deviated from the precedent cases [*Southernport* and *Letaba*] is the case of *Indwe*[165] where the court held that an agreement to negotiate a further agreement is in principle binding because it imposes an implied duty on each party to act honestly and reasonably in conducting the negotiations.[166]

Further, the court held that the applicant was entitled to the interim relief sought. The court accepted that the applicant had established, *prima facie* right that the parties had entered into a preliminary agreement to negotiate a one-year aircraft and auxiliary services contract; and the respondent had breached the preliminary agreement. Blignault J also held that the preliminary agreement was not void for uncertainty.[167]

On more than one occasion the court on *Indwe* referenced to *Southernport* as the basis and leading case that determines under which circumstances can agreements to agree be found to be enforceable. Yet the very same facts that the court found itself to be dealing with lacked both the principles required by *Southernport* [undertaking to negotiate in good faith and dispute resolution mechanism] and found in favour of the applicant on the grounds of reasonableness and good faith. This in view of the court in *Southernport* having emphasised that the requirement of good faith cannot be viewed in isolation but hand in hand with the dispute resolution mechanism.[168]

I am of the view that this judgement was unusual and controversial as it deviates significantly from the clear principles of the leading cases on this subject matter.

In another case where the development of the law of contract was discussed in respect of agreements to agree after *Indwe* was in the case of *Everfresh,* where the Constitutional Court

[165] 2012 (6) SA 96 (WCC).
[166] *Indwe* para26.
[167] *Indwe* para27, 44-45.
[168] *Southernport* para17.

was faced with a request to develop the common law in relation to agreements to negotiate on the basis of the principles of good faith and *ubuntu*.
Both the majority and minority judgments make express mention of the importance of good faith, however no firm decision relating to good faith was made in the *Everfresh* case, as the matter was not properly pleaded. The significance of the case can be found in the *obiter* statements by the court, relating to future developments in the law of contract.

The learned judge, writing the minority judgment of the court expressed the following views on good faith: "Good faith is a matter of considerable importance in our contract law and the extent to which our courts enforce the good faith requirement in contract law is a matter of considerable public and constitutional importance. The question whether the spirit, purport and objects of the Constitution require courts to encourage good faith in contractual dealings and whether our Constitution insists that good faith requirements are enforceable should be determined sooner rather than later. Many people enter into contracts daily and every contract has the potential not to be performed in good faith. The issue of good faith in contract touches the lives of many ordinary people in our country".[169]

These observations were *obiter dicta*, as the majority of the court ultimately held that *Everfresh*'s arguments and calls for the common law of contract to be developed in terms of section 39(2) of the Bill of Rights should not have been raised for the first time in the Constitutional Court.

The *obiter* remarks of Moseneke J in *Everfresh* clearly indicates the Courts' appetite for developing common law in agreements to agree, as the court in this case stated that "Where there is a contractual obligation to negotiate, it would be hardly imaginable that our constitutional values would not require that the negotiation must be done reasonably, with a view to reaching an agreement and in good faith".[170]

One remains interested in future decisions specifically in respect of LOIs in public procurement.

[169] *Everfresh* para22.
[170] *Everfresh* para72.

Chapter 5

RULES OF INTERPRETATION OF THE CONTENT OF LETTERS OF INTENT

5.1. Outline

Contracts are fundamental in the nature of doing business. In a commercial sense contracts regulate and define boundaries of the manner in which parties collaborate with each other.

Public procurement is a form of process that requires stricter oversight than normal consumer contracts, for example Section 217 of the Constitution imposes the requirements of fairness, equity, transparency, competitiveness and cost-effectiveness over and above its contractual obligations. Apart from the fact that Stats SA estimates public procurement to contribute approximately 17% of gross domestic product (GDP),[171] its regulation is also important as the government does not contract on its own behalf, but in the interest of the public. It is therefore vital that this type of contracting is above board to avoid corruption.

As discussed in chapters above; the courts have traditionally treated an agreement to negotiate another agreement as void for uncertainty, because of the absolute discretion vested in the parties to agree or disagree due to the principle of freedom of contract.[172]

What becomes critical to determine in LOIs is the question of whether it was made with an intention to conclude a legally binding agreement (*animo contrahendi*) or whether it was made to be accepted on a provisional basis only, and that a conclusion of a binding agreement was to be dependent on agreement of the further outstanding points as analysed in the preceding chapters.

In the case of *Command*[173] the court describes the nature of an "agreement to agree" as follows:

[171]http://www.statssa.gov.za posted 26 May 2015 (first date accessed 10-6-2017).
[172] *Firechem* para35.
[173] 2013 (2) SA 133 (SCA) p12 of the Judgement.

"It frequently happens, particularly in complicated transactions, that the parties reach agreement by tender (or offer) and acceptance while there are clearly some outstanding issues that require further negotiation and agreement. Our case law recognises that in these situations there are two possibilities; the first is that the agreement reached by the acceptance of the offer lacked [*animus contrahendi*] because it was conditional upon consensus being reached, after further negotiation, on the outstanding issues. In that event the law will recognise no contractual relationship, the offer and acceptance notwithstanding, unless and until the outstanding issues have been settled by agreement. The second possibility is that the parties intended that the acceptance of the offer would give rise to a binding contract and that the outstanding issues would merely be left for later negotiation. If in this event the parties should fail to reach agreement on the outstanding issues, the original contract would prevail".[174]

As the nature of LOIs cannot be finally determined by reference to offer and acceptance only, one may investigate whether the application of rules and theories of interpretation might not shed some light on the problem. The primary purpose of interpretation of the wording used in a contract is to give effect to the intentions of the parties.[175] Where a contract has been put into writing, the language used by the parties is frequently vague or ambiguous and if a dispute arises as to what the parties meant, it becomes necessary to ascertain what in fact they did intend. In ascertaining their intention various rules or canons of construction are employed.

The chapter will give a brief overview on the presumptions of interpretation and various terms that are applicable to LOIs:

5.2. Presumptions of interpretation

Presumptions are derived from the assumption that the parties applied certain principles in concluding their contract.

[174] *Command* para12 of the judgement.
[175] Hutchison 255.

Presumptions require the interpreter to provisionally accept a certain interpretation of a document, until such a time other factors prove otherwise, in which case presumptions are spent and the provisional reconsidered in the light of those other factors.[176] They also illustrate the serious importance of common law.

The purpose of presumptions is to fill in gaps that the parties would have left unsaid in their written contract. In essence, they supplement text and as well gives clarity to the principle of reasonableness and fairness. Drafters should take this role as a warning to actually draft a contract in such a way that the law cannot impute a certain meaning in the contract. Their application is used to shed light in the interpretation process and to also demonstrate the relationship between the contract and the legal system as a whole.[177]

In most occasions, presumptions are rebuttable and the onus to prove that a presumption is not applicable resides with the party who wishes to rebut a presumption. The principle of such evidence is that the one who disputes must produce evidence that there is an alternative conclusion to be reached other than the one originating from the presumption. In the context of LOIs, the study will discuss the presumptions below;

5.2.1. parties choose words precisely and exactly;

There is a presumption that parties carefully chose the words they applied, so that the words express their intention precisely and exactly. Further that the parties generally express themselves in language calculated without manoeuvre or concealment to embody the agreement at which they have arrived, and shape which their contract assumes is what they intended it to have.[178] This presumption goes hand in hand with "the same word or expression in the same contract has the same meaning"; and "different words or expressions indicate different meanings". In LOIs words are critical whether they will be binding or not, depends on their content.

5.2.2. parties do not write what they do not intend

According to Cornelius "the presumption that no person writes what he or she does not intend lies at the base of the interpretation of any document and gives effect to

[176] Cornelius 95.
[177] Cornelius 96.
[178] Cornelius 100.

the general rule of Roman-Dutch law that no person ought to go counter to his or her own act."[179]

A further presumption is that the intention of the parties is aligned to the words contained in the contract; which consequently matches the presumption in favour of the ordinary meaning of the words as the basis of interpretation.[180] Where LOIs are concerned their content will also be subject to this presumption as the words used becomes critical in drawing an inference regarding consensus.

5.2.3. parties intend to conclude a legally valid contract

Cornelius states that "it is a fundamental principle in our law that every person is presumed to be law abiding and innocent of wrong doing, unless the contrary is proven. It follows that when a person concludes a contract, he or she would presumably wish to do so in accordance with the existing law and it is in the public interest that a contract that was concluded freely should be enforced".[181]

When interpreting LOIs this becomes critical where there is an acceptance from the state conditional on a further conclusion of a future contract. The issue is that the bidder made an offer with the intention to enter into a binding agreement should it be accepted, however the conditional acceptance by the state makes it difficult to assume mutual intention from both parties. So again, the test will be as described in the *Southernport*[182] case (per Judge Ponnan) with regards to the intention of the parties.

5.2.4. parties intend for a reasonable and equitable result

This presumption supports an interpretation that does not give unfair or unreasonable advantage on one party over the other.

[179]Cornelius 104-105.
[180]Cornelius 105.
[181] Cornelius 105 (various public procurement legislations are mandatory for an example the PPPFA and its regulations).
[182] 2005 (2) SA 202 (SCA) para33.

The interpreter should make a presumption that the parties meant only what is reasonable and should not interpret a contract in such a way that one party acquires an unfair or unreasonable advantage over the other.[183]

This is critical for public procurement as the state can take advantage or abuse its power and size over a small supplier.

5.3. Interpretation of letters of intent

"When a legal instrument has to be interpreted, the interpreter should ascertain the nature of the document; in doing that, they must determine the unique rules and principles that are applicable including the sphere of substantive law that applies for a conclusive interpretation".[184] This view is supported specifically because public procurement is subject to a litany of legislative requirements and in respect of LOIs such legislation must be applied in their use.

After the *KPMG Chartered Accountants (SA) v Securefin Ltd*[185] case, it has now become clear that there is little difference in interpretation of various kinds of documents. The same rules of interpretation apply to most documents regardless of their nature.

Since LOIs are generally regarded as not binding for uncertainty, the basis of classification[186] becomes critical for their interpretation as it includes amongst other things an analysis of "form"; the 'intention of the author"; the "purpose of the document" etc.

The classification process is seen as an evaluation of the characteristics of a document. It is concerned with determining the characteristics of an instrument and ascertaining the relation of those characteristics of the ideal model of a certain kind of instrument for it to be classified as such.[187]

[183] Cornelius 111.
[184] Cornelius 119.
[185] 2009 (4) SA 399 (SCA).
[186] Cornelius 120.
[187] Cornelius 120.

Form is the most important criterion for the classification of a document such as an LOI as its phrasing can be used as evidence to determine the author's intention with regard to the nature of the document. In this case then, the characteristics of LOIs will have to be specific enough to indicate if they were made with an intention to be binding.

How does one determine the intention of the author or the meaning of text in the document? Cornelius clarifies the issue as follows: "A document can only have an author in a legal sense, that is if there is some kind of legal message embedded in the text contained in that document, and if the author intended some legal consequence to follow from that document".[188]

One supports Cornelius in his explanation that the above as drafting legal instruments should contain a legal message and should depict the intention of the parties so well that the court must not be faced with making up a contract for parties when interpreting it.

From a classification process, the purpose of the document may also assist in determining the nature of the document and it seems in the case of LOIs this will be applicable if the letter is actually used as provisional contract for the supplier to commence work instead of a provisional appointment for a conclusion of a future agreement.

It is an accepted principle of interpretation that the extent of text should be established, and a term of a contract should be read in context not in isolation.[189]

When parties conclude a written contract much inevitably remains unexpressed. It would be impossible for parties to contemplate all possible eventualities and provide for them in their contract. As a result, the law has long since recognised that the express terms of a written contract can be supplemented with other unexpressed terms.[190]

The case of *Alfred McAlpine & Son (Pty) Ltd v Transvaal Provincial Administration*[191] is a landmark case that the courts have relied on in upholding the principle of unexpressed terms in a contract which indicated that the courts only limited unexpressed terms into two kinds only. The court distinguished between tacit and implied terms; it explained that a "tacit term"

[188] Cornelius 122.
[189] Cornelius 139.
[190] Cornelius 139.
[191] 1974 (3) SA 506 (A).

is based on the actual unexpressed intention of the parties, whilst an "implied term" is imposed by law.[192]

Cornelius explains and gives clarity with regards to the other unexpressed terms to be considered when interpreting a contract.[193] In his opinion, the decision of *Baker Tilly*[194] is significant in South Africa as the law relating to the unexpressed terms of a contract is based on English law. It provides some critical insights on how South African courts should deal with unexpressed terms, particularly because the court emphasised that it is a term implied in the contract because it reflected the actual intention or common understanding of the parties which they had failed to express where the written contract did not constitute a complete integration of the agreement between the parties.

In the context of evaluating LOIs the intention of the parties is critical therefore the requirements must be clear in the drafting process.

5.3.1. Express terms

> These refer to promises and matters related thereto, which parties have set out in words in the operative part of their contract. Any words in a written contract which impose an obligation on any party amount to an express term by that party to perform that obligation. To that extent, it can be said that a contract can only be understood with reference to express terms.[195] In the case of *ABSA Bank Ltd v Swanepoel*[196] the court held that "At its simplest, a contract is an enforceable promise to do or not do something. But when parties record an agreement in writing, they often add provisions that do not embody such promises. It may contain 'recordals' and 'recitals'. It may document prior events or record the parties' future intentions. It may contain clarificatory or explanatory statements. The parties may place on record matters that bear on the interpretation of what they have undertaken. It is therefore wrong to approach a written contract as though every provision is intended to create contractual obligations".

[192] Cornelius 145.
[193] Cornelius SJ Baker Tilly (a firm) v Makar 2013 Vol 4 *De Jure* 46.
[194] [2010] EWCA Civ 1411.
[195] Cornelius 149.
[196][2004] ZASCA 60 para6.

This is critical for LOIs as they normally record prior events [refer to tender documents], and future intentions of parties [intention to conclude a future (main) agreement].

It is stated that the express terms of a written contract are not all contained in a single document. Express terms may also comprise of terms in other documents that are incorporated into the contract by reference [for an example tender and legislation]. However, the interpreter must always bear in mind the principles of the law of contract regarding offer and acceptance in public procurement and privity of contracts.

In all public procurement, the response to a tender is an offer that must be accepted or rejected by the state, therefore the express terms made must be read holistically.

"In cases where terms in other documents or notices are incorporated into a contract, they must be read as if they had been written out in full in the contract concerned".[197]

5.3.2. Consensual tacit terms

The terms that relate to matters which the parties have agreed upon or which the parties had some common expectation but fail to express their agreement on that matter in their written agreement are called tacit or unexpressed terms. In this case, the agreement or the common expectation with regard to the issue concerned may be read into the contract as a tacit or unexpressed term.

In the case *of Homsek (Pty) Limited v J.W. Muller & Seun*[198] it was held that "a tacit term cannot be imported into a contract on any matter to which the parties have applied their minds and for which they have made expressed provision for in the contract".[199]

In LOIs this may have an impact, particularly because consensual tacit terms are derived from the agreement between the parties which is to conclude a further agreement. Consequently, a determination whether a consensual tacit term should

[197] Cornelius 150.
[198] [unreported] CASE: A33/2014 para24.
[199] *Homsek* para25.

be inferred in a contract or not, is a question of fact and is subjective. It must take into consideration the conduct of the parties which must be indicative of an intention to be bound by the proposed term.[200]

5.3.3. Imputed tacit terms

These are terms concerning matters which the parties had not considered, but they would have agreed to the terms concerned had their attention been drawn thereto at the time when they concluded the contract. Terms of this nature are based on the assumed intention of the parties.[201] For instance in a case where the tenderer is expected to commence work upon the issuing of an LOI.

It is explained that "a term can be imputed in a contract if the parties did not, in fact apply their minds to it, but if an officious bystander had asked them if it should have been in the contract, they would unhesitatingly have responded in the affirmative".[202] There are critical observations to make about this term, particularly when interpreting LOIs. One must have reached a conclusion that a binding agreement exists, the bystander test has been satisfied; effect will be given to the contract or possible performance. In a case where there is doubt about whether the parties would have reasonably agreed, alternatively the proposed term contradicts an express term of the contract, such term cannot be imputed.[203]

5.3.4. Implied terms:

They refer to terms that are inferred *ex lege* in a contract, despite the fact that the parties did not reach or would not have reached agreement on the matters involved. They are derived from the common law, statute, precedent, custom or trade usage and are not dependent on the actual or presumed intention of the parties.[204]

One can describe implied terms as nothing more than duties which the law imposes on contracting parties, including public policy, elements of justice and fairness.

[200] *CGEE Alsthom* p29.
[201] Cornelius 153.
[202] Cornelius 153.
[203] Cornelius 154-155.
[204] Cornelius 157.

In the case of the state being a contractant, it will be bound by constitutional provisions, public policy and other legislation applicable.

When examining the nature of LOIs by analysing its contents, one cannot ignore the applicable rules of interpretation, as an LOIs are forms of legal instruments.

Chapter 6

RECOMMENDATIONS ON THE DRAFTING OF LETTERS OF INTENT

6.1. Outline

Amongst other requirements of a valid contract certainty is a critical requirement of a contract. Why is this requirement particularly important where LOIs are concerned? The general viewpoint is that they are not enforceable because of uncertainty. This could be addressed by proper drafting practices.

6.2. The concept of drafting

The essence of legal drafting is the attempt by the drafter to convey a certain message to the eventual recipient or adjudicator of the legal instrument. The drafter's aim should be to convey the message as clearly and accurately as possible.

The drafter must ensure that the instrument which is drafted is always valid and compatible with the substantive law of contract.

6.3. What is certainty in the context of LOIs?

The general rule is that uncertainty about what must be performed prevents the creation of obligations.[205] Hutchison states that certainty requires that the agreement must have a definite or determinable content, so that the obligations can be ascertained and enforceable.[206]

Hutchison further confirms that in respect of a contract aimed at creating another contract or 'agreement to agree' can be invalid due to uncertainty. "If the parties' consensus is only provisional, and subject to further variation, depending on the further negotiations, or the

[205] See the requirements of a valid contract in chapter 2 above.
[206] Hutchison 6.

further advise of a party's attorney, the content of the contract is too uncertain to give rise to the obligations".[207] This was the principle as confirmed in the *Firechem* case.[208]

The second situation where an agreement to agree would be valid is provided that the terms of the envisaged agreement to be made in the future are agreed upon.[209] This was confirmed in the leading case of *Southernport*[210] where the court held that, the agreement was not an invalid agreement to agree, since the arbitration procedure created sufficient certainty as to the ultimate content of the agreement.

This is a critical legal principle on agreements to agree, despite the ununiformed approach of the courts[211] in respect of these provisions, legal certainty is required going forward.

The case of *Southernport* contains some key principles as Judge Ponnan particularly addressed this fact and emphasised on what agreements to agree should contain for them to be valid. Amongst other things he asserts that an agreement to agree should at least contain the following provisions for it to be valid and enforceable:

(a) A dispute resolution mechanism;
(b) The duty to participate in good faith negotiations [undertaking by parties to negotiate in good faith].

6.4. Recommended clauses for drafting a letter of intent

This study attempts to make recommendations on what to include when drafting a letter of intent, particularly in view of the abovementioned requirements. The study below presents abstracts from 2 cases below:

[207] Hutchison 212.
[208] 2000 (4) SA 413 (SCA) para35.
[209] See footnote 207 above.
[210] 2005(2) SA 202 (SCA).
[211] *Brink v Premier of Free State* 2009(4) SA 420 (SCA).

6.4.1.

Annexure A

A Letter of Appointment used in the case of *Command Protection Services (Gauteng) (Pty) Ltd v South African Post Office Ltd* 2013 (2) SA 133 (SCA) [which in this case the court held that the letter of appointment was not binding]

["LETTER OF APPOINTMENT

It is with pleasure that we inform you that the Tender Board has awarded the above tender proposal to [you]. As a result, you are appointed as the supplier of the above-mentioned service as per our tender proposal.

This appointment is subject to the following:

BEE improvement; and

The successful finalisation and signing of a formal contract.

A draft contract will be forwarded to you within (7) seven working days for your comment and to the effect mutually agreed on amendments and finalisation into a formal contract. You are kindly advised to acknowledge receipt of this letter of appointment and provide this office with the contact information of the person(s) responsible for the finalisation of the contract process.

Yours sincerely

[Signed on behalf of the appellant]

Accepted and signed on behalf of the respondent]".[212]

[212]P12 para5 of the judgement [referred to as PC3].

6.4.2.

Annexure B

The recommended clauses [abstract] taken from the *Southernport Developments (PTY) Ltd v Transnet Ltd* 2005 (2) SA 202 (SCA) case: [the court held in this case that there was certainty, and this was a valid agreement to agree**].**

"Clause 3 of the second agreement, to the extent here relevant, provides:

"3.1.2 In the event that the Tsogo Sun Ebhayi casino licence application fails, and all appeals, reviews and other legal challenges initiated by Tsogo Sun Ebhayi that may potentially prohibit the exploitation of the casino licence granted to a competitor of Tsogo Sun F Ebhayi in the Port Elizabeth zone, Eastern Cape Province (if any) are finally resolved in favour of that competitor then for three years from that date or from the date of the award of the casino licence to that competitor if no such appeal, review or other legal challenge is made as the case may be, Tsogo Sun Ebhayi (or its nominee) shall have the option to lease the properties (or the agreed portions thereof) on the terms and conditions of an agreement (the alternative agreement) negotiated between the parties in good faith and approved by each of the party's board of directors.[213]

'3.4 Should the parties be unable to agree on any of the terms and conditions of either the definitive agreement or of the alternative agreement within 30 days of the date of any notice given by either of such parties to the other of them requiring such agreement, then the dispute shall be referred for decision to an arbitrator agreed on by the parties. The arbitrator's decision shall be final and binding on the parties. If Tsogo Sun Ebhayi and Transnet are not able to agree on that arbitrator within five days of either of them calling on the other to do so, then that arbitrator shall be selected for that purpose by the Arbitration Foundation of South Africa,

[213] This is taken from the *Southernport* case and it specifically addresses the clause that contains undertaking to negotiate in good faith. The court has emphasised that this requirement cannot be a stand-alone but must be coupled by the dispute resolution clause.

and the arbitration shall be finalised in accordance with the Foundation's expedited arbitration rules".[214]

As mentioned in the delineations in Chapter One, contracts are confidential in their nature and most state contracts contain provisions in respect to private arbitration as a preferred method of dispute resolution. This has therefore limited the availability of the LOIs in the public domain, particularly in public procurement. Although one could request access through legislation like (PAIA), but the process is long and tedious.

From the principles discussed above and the reasoning given by both the courts in the above cases. It is my view that a conditional letter of intent will suffice if it contains the provisions as highlighted in the case of *Southernport*. Anything less than these requirements should not be enforceable. Accordingly, the study recommends the inclusion of the above-mentioned clauses detailing good faith and dispute resolution options.

[214]*Southernport* para3 of the judgement (the court confirmed that this clause presented certainty and therefore renders the agreement to agree enforceable).

Chapter 7

CONCLUSION AND RECOMMENDATIONS

7.1 The law as it stands and in accordance with the principle set in *Firechem* is that agreements to agree are not enforceable due to uncertainty. Such uncertainty has been described by the court to emanate from the "absolute discretion vested in the parties to agree or disagree".[215]

The landmark case of *Southernport* became the primary exception to this rule as the court held that an agreement to engage in further negotiations may nevertheless be legally enforceable in the following circumstances where the preliminary agreement contains a dispute resolution mechanism, an express undertaking to negotiate, the parties have already reached agreement on all of the "essential terms" of the ultimate agreement and the relevant further negotiations are needed only to settle subsidiary terms [that are] still within the contemplation of the parties.[216]
The authority for *Southernport* found its support from the Australian case of *Coal Cliff Collerie v Sijehama (Pty) Ltd.*[217] where the court when making the decision was of the view that the principle of enforceability of agreements to negotiate was no different from our law, therefore the principle of this case should be followed.[218]

Judge Ponnan further held that where the above requirements are present they will render a preliminary agreement certain therefore enforceable.[219] More emphasis was given to the fact that the agreement to have the dispute determined by a third party and given a binding decision gave effect to what the parties agreed upon.[220] In respect of the undertaking to negotiate in good faith, the court clearly held that the parties' agreement to negotiate in good faith was not an 'isolate edifice', but was coupled with the dispute resolution mechanism which the latter confirmed in certainty. Accordingly, the court clarified that reliance on good faith alone is not sufficient to render the agreement to agree enforceable.[221]

The recent deviation from the above in the case of *Indwe*, although it sparked controversy it is in my opinion proof enough that there is a desire to accommodate good faith in agreements to agree. The reasoning of the court in *Indwe* was motivated

[215] *Firechem* para35.
[216] *Southernport* para17 and *Letaba Sawmills* p775-776.
[217] 1991 24 NSWLR 1.
[218] *Southernport* para16.
[219] *Southernport* para17.
[220] *Southernport* para17.
[221] *Southernport* para17.

by the fact that there was a duty to negotiate in good faith, but such duty was not undertaken as it was in the *Southernport* case or even coupled by a dispute resolution clause, however the court held that the Applicant has established on a prima facie basis that it concluded a preliminary agreement with respondent to negotiate a further agreement.[222]

The *obiter* remarks discussed in earlier chapters made by Moseneke J in *Everfresh* after *Indwe* clearly indicates the Courts' appetite for developing common law in agreements to agree.

It is therefore submitted that even though there is a desire from the courts as per the obiter remarks above, the judiciary has not made a binding decision about the application of good faith as an independent concept in contracts despite some compelling submissions made to the courts by jurists in different cases, the position thus remains the same.

7.2 The challenges posed by conditional LOIs in Public Procurement can be summarised briefly as follows: LOIs can be used to eliminate tenderers that are not liked by certain officials through frustrating the negotiation process since they know that they may have an option to appoint a different supplier. At times the LOIs are used by officials as an escape to their own red tape and to get tenderers to commence work.

The Regulations[223] are already prescriptive in terms of how proposals are evaluated and the scoring thereof. One therefore wonders why there seems to be a big room to negotiate post the award process? For instance, the Regulations provide for allocation of points to be allocated on price and BEE as discussed in chapter three, accordingly this should be the basis of the appointment as it is prescriptive in nature.

It is my submission that the state would have no reason to leave out some of the proposals [offers] if further room to negotiate other terms is created. Further that the acceptance would then not comply with the firm requirement provided for in the offer and acceptance mechanism discussed on formation of contracts above.

[222] *Indwe* para 35.
[223] 2017 PPPFA Regulations.

One of the purposes of the Government General Contract Conditions (GGCC)[224] is to ensure that tenderers are familiar with the terms of all parties involved in doing business with government[225] What is there to negotiate further?
In view of the above it is my further submission that the state is obliged to create clear legal terms and principles in respect of the use of LOIs in public procurement.

7.3 The following recommendation may be made on the way forward. From the evidence above the conditional LOIs are treated as agreements to agree and are all subject to the principles of the *Southernport* test as discussed above.

Secondly the tender invitation is not capable of being accepted by the highest bidder; instead all public procurement tenders are merely an invitation to the potential bidders to submit proposals which acceptance must be left for the State, as such they can only be [RFQ/RFT/ RFP].[226]

Thirdly LOIs are subject to the offer and acceptance mechanism and must meet such requirements for the creation of contractual liability[227] and lastly the reliance theory may be applied subject to its requirements being met, particularly where the state has created a reasonable belief that consensus was reached and the bidder has reasonably relied on such belief.[228] For instance this could be the case where the state has authorised that the tenderer commences work during negotiations of a further contract and prior to finalisation of such contract.

The study submits that the principles and legal position of the use of LOIs in the public sector thus far have not been satisfactory and argues that since the state is not an ordinary contractant for reasons mentioned above, such clarity and legal certainty is required.
This being said, it is my submission that the courts have not played their Constitutional mandate to develop common law in respect of LOIs in public procurement, instead they have treated all public-sector contracts under the principles of the law of contract. The courts need to engage with open minded concepts such as the ones that seek to promote the values provided for in Section 217 of the Constitution.
They should consider good corporate governance principles and procurement regulatory framework applicable to public procurement through a Constitutional eye.

[224] [as updated in July 2010] http://www.treasury.gov.za (date accessed 8-04-16).
[225] National Treasury Supply Chain Management: A Guide for Accounting Officers.
[226] Hutchison 52,156.
[227] Hutchison 48, 55.
[228] Hutchison 95.

It is my view that the general principles of the law of contract should be applied more cautiously where government contracts are concerned. The courts should always seek to achieve the principles that are embodied in Section 139 and 217 of the Constitution.

Since the awarding of tenders by the state is an administrative action,[229] the LOIs should be compliant with the legislation applicable to public procurement. Further by virtue of the position that the state occupies in public law, it ought to be held to a higher standard than an ordinary contractant since all its contracts are for the benefit and interest of the public.[230] LOIs should thus be defined and included in the procurement legislation and the circumstances under which they must be issued must be clarified with legal certainty. This could be done through National Treasury directives issued from time to time.

One must therefore ask, why is the state continuing to use these letters of intent if generally they are regarded as unenforceable? The answer rests in appetite of the courts to develop common law where public procurement is concerned so there could be amendments in legislation. Constitutionally, it would benefit prospective tenderers if LOIs in public tenders would be standardised to reflect compliance with legal requirements.

It is therefore recommended that the state include the use of LOIs in public procurement regulatory framework and supply chain guidelines to create certainty of what exactly the role of the LOIs is and how far the negotiations could be stretched. This would be in compliance with section 217 of the Constitution.[231]

WORD TOTAL: 17 721

[229] *CShell* para102-104.
[230] Hutchison 156.
[231] When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

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