

Article Information

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Don't judge a book by its cover - when is a heads of agreement binding? Tips and traps particularly for commercial real estate agents seeking to effectively transact binding commitments in a commercial property context.

In the realm of commercial real estate, pre-contract documentation is used frequently by landlords and tenants alike to impress in principle commercial terms and establish a clear meeting of minds in respect of transaction fundamentals. Common descriptors for pre-contract documents include (without limitation) "Heads of Agreement", "Agreement to Lease", "Offer to Lease" or some other derivative of these terms - it is trite to say that these descriptors more often than not signify an intention to create binding legal obligations (which usually aligns with the intention of the agent/party who has prepared the document) but unless the contents support a clear intention to be bound (in objective terms) to a legally enforceable agreement then there will be no binding.

From reading this article, the reader should conclude that label is not important and there is no "one size fits all" approach to pre-contract documentation processes. Pre-contract documents should be tailored to address transaction fundamentals and, if used effectively, are integral to expedient deal progression.

Purpose of HOAs

Commercial property transacts at pace - time is money and delays may result in lost opportunities. The need to establish clear objectives and a binding legal framework conducive to intention is a commercial imperative to maximise opportunities.

A Heads of Agreement or other pre-contract document with a similar title descriptor signifying the existence of a binding contractual commitment (which herein will be taken to be an 'HOA' for the purposes of this paper) is typically a pre-contract document that outlines key contractual objectives and commercial imperatives predicating a commercial transaction.

Properly managing the pre-contract phase through the use of an HOA is essential to:

- streamline the documentation and negotiation process;
- impress "moral obligations" preventing departures from agreed positions;
- create certainty in relation to core/essential terms;
- establish conditions precedent which must be satisfied (or waived) before a binding legal commitment arises;
- ensure an alignment of objectives and targets for the contract and transaction process;
- allow the parties to address any misunderstanding or problems;
- ensure a "meeting of minds" on essential terms to avoid unilateral, mutual or common mistakes/errors/misapprehensions;
- give efficacy to exclusivity and confidentiality obligations;

- give efficacy to a due diligence regime including obligations to support any development application and to procure comprehensive information to complete a phase 1 environmental site assessment;
- ensure an alignment of objectives and targets for the contract and transaction process; and
- give efficacy to “good faith” negotiation obligations and implementation of a timetable for progression of the transaction including designations in respect of task and responsibilities.

There is a balancing act between too much detail and too little:

- too much detail – this may cause delay / transaction paralysis, increase transaction costs where concepts are overengineered and/or subject to multiplicitous drafting/negotiations and may evince an intention to be bound (which depending upon circumstances may not be intended) ; and
- too little – that may mean that none of the key commercial issues have been addressed with no deal to be done.

Legal Pitfalls and Risks

HOAs, if used effectively, are of great utility. However, if not drafted with careful consideration of relevant transaction principles, intentions and objectives, HOAs may have unintended and inadvertent consequences giving rise to unexpected legal obligations under misapprehension.

The enforceability of HOAs is governed by the principles espoused in *Masters v Cameron*^[1], where the High Court of Australia identified the following possible outcomes regarding the binding nature of HOAs:

- **Unconditional performance:** Both parties agree to all terms and intend to be immediately bound, but will formalise the agreement later.
- **Conditional performance:** The parties agree on all terms but make performance conditional on executing a formal document.
- **No concluded bargain:** The parties do not intend to be bound until a formal contract is exchanged.

In *Masters v Cameron*, the Court found that agreements in the first two scenarios are binding, while the third is not.

Key Contractual Elements

Application of the ruling in *Masters v Cameron* boils down to the intent of the parties to conclude a binding agreement when drafting a HOA (whether or not that agreement is conditional on execution of formal documentation).

When categorising a HOA into one of the categories specified in *Masters v Cameron*, several key elements of contract law must be considered:

- **Offer, Acceptance, and Consideration:** There must be a clear offer and acceptance, supported by consideration (something of value exchanged).
- **Capacity:** Ensure that the party signing the HOA has the authority to do so, especially when approval is needed from a higher body (for example, a board). HOAs are often entered into on an operational level and as such are often phrased as being “subject to board approval”. These situations may create difficulties in determining whether the party entering into the HOA has the capacity to do so. Whether the executing party has authority to contract on behalf of the contracting party must be assessed when considering the issue of capacity in the context of determining whether a HOA is binding.
- **Intention:** Courts assess intention objectively, focusing on the parties’ outward conduct. Generally speaking, the Court will look at partial performance as a very persuasive factor when determining an intention to create a legally binding document.

In *Darzi Group Pty Ltd v Nolde Pty Ltd*^[2], the Court found that despite the HOA being subject to further negotiation and formalisation, the parties had demonstrated a clear intention to be bound by the terms of a lease contemplated by the relevant HOA (on account of the performance of the parties of certain lease obligations including that the tenant took possession of premises). This case emphasised the importance of determining the objective intentions of the parties, which is assessed based on their conduct and the specific wording of the agreement.

The nature of the conduct doesn’t need to be strictly linked to performance of any obligations specified in the HOA either. For example, in *Casdar Pty Ltd v Fanous*^[3], partial performance of obligations under an HOA did not create a binding lease commitment chiefly because the landlord failed to meet statutory disclosure requirements under the *Retail Leases Act 2003* (Vic).

The takeaway from this case being that a landlord’s compliance with statutory obligations holds great weight when it comes to determining whether the parties intended to be bound by the terms of a HOA (this is applicable in both the

context of leasing and capital transactions).

- **Certainty:** The terms of the HOA must be sufficiently clear to form a binding contract. This was reflect in *Patel v Sengun Investment Holdings Pty Ltd*^[4], on the basis that the HOA contained “*all of the terms that would be essential for the constitution of an agreement for the sale of land*” even if further agreements were anticipated.^[5]

Overall, this decision makes it clear that the fact that a HOA may contemplate the formulation of a contract of sale, which might contain further terms and conditions, does not, of itself, preclude the conclusion that the HOA constitutes a legally binding contract by the parties.

Practice Tips

HOAs are commonly used in contract negotiations, but their enforceability may sometimes be unclear.

HOAs may be structured to be legally binding, partially binding or not binding at all. The most common legally binding provisions for HOAs include:

- confidentiality provisions,
- exclusivity; and
- obligation to negotiate binding documents expressed as a best endeavours obligation (and not an absolute obligation).

Any provision in an HOA to negotiate in good faith is important and should set out the relevant standards and timeframe applicable to the negotiation process. It is important as at common law there is no general duty to negotiate good faith.

To be binding:

- an HOA should expressly stipulate that it is binding;
- the document should be sufficiently comprehensive with regards to obligations intended to be binding; and
- the clauses in the HOA which are intended to be legally binding should be clearly identified – clauses might include those relating to confidentiality and privacy, intellectual property, exclusivity, costs and governing law.

To avoid an HOA being legally binding it is recommended that:

- the HOA should make it unequivocal that the document is merely a term sheet.
- the HOA include a clear sunset date specifying when the HOA becomes void if a formal agreement is not finalised by that date;
- the parties avoid specifically performing obligations before final documents are executed (whether these are contemplated by the HOA or statutorily mandated);
- avoid the use of mandatory language;
- caveat the finality of transaction elements by making them subject to formal legal drafting; and
- the scope of the HOA be limited to prevent it from being assessed as a binding commitment – overly prescriptive HOAs are more likely to give rise to binding commitments.

The benefits of a HOA are extensive but their application requires prudent assessments to be made with regards to objects and intentions of the parties.

For commercial agents, it is strongly recommended that:

- pre-contract templates are reviewed to assess purpose and drafted with sufficient guidance notes to ensure they are used to effectively to create binding legal obligations (if appropriate in the circumstances);
- commercial agents are educated to effectively elicit instructions (from all parties) to enable the purpose and objects of the pre-contract document to be enshrined in the pre-contract document;
- complex transaction concepts requiring legal nuance should be caveated as a non-binding concept subject to prescriptive legal drafting;
- commercial agents develop a basic understanding of implied statutory requirements which may affect a pre-contract document intended to create binding legal obligations (including with regards to statutorily implied tenure);
- commercial agents develop a matrix of obligations intending to be binding applicable to the pre-contract document;
- severable legal obligations capable of independent enforcement (such as confidentiality and exclusivity) should be expressed as absolute and binding with the use of appropriate mandatory language (capable of supplantation of formal transaction documents); and
- include appropriate boilerplate requirements to address fundamental legal concepts such as governing law,

interpretative rules and costs.

[1] *Masters v Cameron* (1954) 91 CLR 353

[2] *Darzi Group Pty Ltd v Nolde Pty Ltd* [2019] NSWCA 210

[3] *Casdar Pty Ltd v Fanous* [2017] VSC 616 ; BC201708791.

[4] *Patel v Sengun Investment Holdings Pty Ltd* [2023] VSCA 238; BC202314108

[5] *Ibid* [68]