

## Article Information

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## When “non binding” isn’t risk free: Heads of Agreement and preliminary documents

***Heads of Agreement and similar preliminary documents are commonly used to set the key terms for a deal and provide the framework for negotiations.***

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As discussed in our recent **Clause & Effect | Foundations Stream** webinar on [Heads of Agreement & Preliminary Documents](#), these documents are very useful, but can carry real legal risk if not clearly drafted.

This insight explores why preliminary documents are used, when they may become binding (intentionally or otherwise), and practical steps to manage risk during negotiations.

### What’s in a name?

For convenience, we refer to “Heads of Agreement” in this insight. Other descriptions include term sheets, memoranda of understanding, letters of intent or heads of terms. The name itself does not dictate how binding the document is – it’s the contents that count.

### Why use a Heads of Agreement?

A Heads of Agreement (HoA) can be a useful commercial tool. At its best, it helps parties:

- establish that the deal is real
- focus early stage negotiations on the most important issues
- set guard rails and get key requirements on the table
- set a framework and timetable for negotiations
- agree process requirements like confidentiality or exclusivity

It is important to remember that a HoA is not just an administrative step. It often shapes the entire deal trajectory, and may be important evidence if there is a dispute.

Broadly, a preliminary document may fall into one of three categories:

1. **Immediately binding** - a concluded agreement, even if a more formal document is expected later
2. **Partly binding** - binding for certain clauses only (for example, confidentiality or exclusivity)
3. **Not binding at all** - simply a statement of terms agreed in principle as the starting point for a negotiation

Which one applies depend on the intention of the parties.

### Intention is assessed objectively

A central theme of the webinar was intention. There is no contract until the parties intend to enter into legal relations. The *subjective* intention of a party is not relevant. The evidence is considered *objectively*: the Court looks at what their words and conduct would lead a reasonable person to understand.

The statement: “this agreement is not binding” is clear, but it is only clear about that point in time.

**“Subject to contract” may not get you off the hook**

The phrase “subject to contract” is indicative that there is no contract, but it is not determinative by itself.

Courts will look beyond labels and assess the document as a whole, including the surrounding communications and conduct. And, the meaning the Court puts on a word or phrase might not be what the author intended.

Australian courts have repeatedly emphasised that the effect of “subject to contract” depends on context. Where parties agree key terms, act consistently with having reached agreement, or begin performance, there may be a binding contract even though the parties intend to negotiate and sign a formal and comprehensive agreement and have not yet done so.

The practical lesson is clear: words, structure and conduct must align. Inconsistent drafting or behaviour can undermine an otherwise clear intention not to be bound (and vice-versa).

### **The preliminary agreement is just the start**

A preliminary agreement that parties are not bound until the formal agreement is not the end of the matter.

The intention you express today does not bind your future conduct, and that conduct may later show (*objectively*) a changed intention. If you do not want to be bound, you must keep making that sufficiently clear.

This risk is heightened where parties:

- agree most commercial terms early
- incur significant costs in reliance on negotiations
- communicate urgency or reliance
- allow performance to commence before final execution

Statements about the importance of an agreement to a party’s next actions, or their reliance on the agreement, may show a change of intention. Allowing a party to act to their detriment may also be *unconscionable*.

Even where no contract is found, conduct may give rise to estoppel or restitutionary claims if one party has acted to its detriment in reliance on the other.

### **The risk of deal creep**

A well drafted Heads defines the scope of the intended agreement. It’s hard to introduce new terms when, you know - you just signed your agreement to the key terms. Nobody likes deal creep, but matters left unsaid in the Heads will open the door to that behaviour.

### **Partially binding clauses: clarity is critical**

It is common, particularly in government, statutory corporation and regulated environments, for certain provisions to be binding even where the overall document is not.

These clauses typically deal with issues relevant to the negotiation such as:

- confidentiality
- exclusivity or standstill arrangements
- early due diligence rights
- who bears costs
- intellectual property protection

Best practice is to clearly identify binding provisions and expressly state that all other terms are non-binding and subject to execution of final transaction documents.

### **Purchase orders and the “battle of the forms”**

A recurring question in the webinar concerned seller proposals followed by customer purchase orders.

Where a seller issues a proposal (often with seller T&Cs) and the customer responds with a purchase order referencing different terms, parties may find themselves in a classic battle of the forms scenario.

If performance commences without resolving that inconsistency, courts will look at the parties’ communications and conduct to determine which terms prevail, sometimes with unexpected results.

**Key takeaways**

For those early in their legal or commercial careers, preliminary documents offer valuable learning opportunities and real responsibility. Key takeaways include:

- be explicit about intention and commitment
- align drafting, communications and conduct
- document important discussions in writing
- assume preliminary documents may be scrutinised later
- remember that “non-binding” does not mean “risk-free”

Careful drafting at the outset can prevent significant disputes down the track.

*This insight draws on content presented in the [Clause & Effect | Foundations Stream webinar: Heads of Agreement & Preliminary Documents](#). If you would like to discuss this topic further, please contact the authors.*

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