

HEADS OF AGREEMENT

DO YOU KNOW WHAT YOU ARE GETTING INTO?

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A “Heads of Agreement” sets out the commercial terms of a proposed Lease, and is often entered into between prospective Tenants and Landlords during lease negotiations. Such an agreement may be effective to create a framework for the parties to negotiate a final Lease, and to provide a level of confidence that the parties are committed to negotiations and that a deal is likely - *but do you know what you are getting into?*

Depending on how it is drafted, a “Heads of Agreement” may be a non-binding preliminary document, or it may create a **binding contract or Lease**. While generally envisioned to be the former, as with most documents in a legal context, the name of the document is of minor importance. Rather, one must look to the underlying nature of the document to deduce whether it is legally binding. If the agreement contains the elements of a contract – offer, acceptance, consideration and *intention to be legally binding*, then it will be binding on the parties. What’s more is that a Heads of Agreement will often satisfy the requirements of the Property Law Act 1958 –that an agreement to create an interest in land must be signed and in writing.

The solution for those who do not wish to be bound by the terms of a Heads of Agreement is to ensure that the agreement **clearly and unequivocally** expresses that the parties do not intend to be bound by its terms and that the agreement is subject to preparation and execution of a formal Lease and agreement being reached as to the terms of the formal Lease. Likewise, a party who intends for a Heads of Agreement to be legally binding should clearly state this in the agreement to avoid potential disputes and unnecessary costs.

There may be other unforeseen consequences where a Heads of Agreement is found to be binding – beyond simply compelling the parties to enter into a Lease.

For example, where a Lease is of a retail shop the provisions of the *Retail Shop Leases Act 1994* (“the Act”) require the Landlord to provide disclosure documents to the Tenant prior to the Lease being “entered into”. Section 11 of the Act provides that a Lease is entered into on the earlier of the date the lease became binding on the parties or the date the Tenant enters into possession of the leased shop. The definition of “Lease” within the Act is also broader than the usual understanding of the word and means ‘an agreement under which a person gives or agrees to give to someone else for valuable consideration a right to occupy premises’. Therefore, where a Heads of Agreement was not contemplated to be binding, but is in fact binding, it is unlikely the Landlord will have complied with their disclosure obligations. The consequence is that the Tenant may end the Lease within 6 months and the Landlord is liable to pay the Tenant’s reasonable compensation.

Another concern is that in many instances, the basic commercial terms set out in a Heads of Agreement are insufficiently detailed and often fail to deal with more specific but nevertheless important details such as GST treatment, make good and security requirements.

We suggest that, prior to signing a Heads of Agreement you have a lawyer review the agreement as the consequences for getting it wrong may be costly.