

Level-headed

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While heads of terms are essential to a contract, they can have pitfalls. Stephen Gawne clarifies the situation

A full, clear set of heads of terms is an important element of commercial property transactions, to record accurately the scope and principal points of any agreed deal. They should enable the transaction to proceed to its final stage, the settling and completing of the legal documentation.

The name of a document does not determine its legal status

It is important, though, to ensure that any heads of terms are not inadvertently legally binding. That would be contrary to their purpose, and would run the risk of leaving the parties saddled with an agreement at odds with their particular requirements.

Non-binding terms

It is well established that the name of a document does not determine its legal status, so calling a document 'Heads of terms' will not ensure that it is not legally binding. All heads of terms should be marked 'subject to contract'. In England and Wales, the addition of this wording will help to negate the presumption of contractual intent, although that is not guaranteed. Adding 'without prejudice' to heads of terms, while a common practice, is not appropriate. Those words simply have no meaning in the context, and should not be included.

Even with a statement that heads of terms are 'subject to contract', the risk of creating a binding contract still exists, however, where the transaction satisfies the following criteria:

- it includes the general legal requirements for a contract: offer, acceptance, consideration, intention to create a legal relationship; and
- it meets the requirements of [section 2 of the Law of Property \(Miscellaneous Provisions\) Act 1989](#) , specifically that a contract for the sale or other disposition of an interest in land must:
 - be in writing;
 - incorporate the terms expressly agreed between the parties; and
 - be signed by or on behalf of each of the parties.

These create a trap that has led courts in a number of cases to hold parties bound by an agreement marked 'subject to contract'.

Particular care needs to be taken when dealing with short-term leases, as these can be created orally. An exception to the general rule that a lease must be made as a deed applies to where their term does not exceed 3 years, and the risk of heads of terms being found to be legally binding for those leases is particularly significant.

In all cases, a specific statement should be added to the heads of terms on the lines of: 'These provisions are not intended to be legally binding'. That statement, together with the 'subject to contract' qualification, will provide good evidential grounds to rebut a presumption of contractual intent.

Conversely, any parts of the heads of terms that are intended to be legally binding should specifically say so. Certain pre-contract matters such as confidentiality, exclusivity and penalty costs provisions should be dealt with by specific agreements to be drawn up by solicitors. Those separate agreements would be essential to allow any claim for breach.

Covering the essentials

As to what heads of terms should cover, they should clearly be an accurate reflection of what the parties have agreed. Even if terms are properly produced as non-legally binding, a party will find it difficult to secure any departure from the agreed heads in subsequent negotiations. They do carry a certain commercial and, dare we say it, moral weight. It is certainly tough for solicitors to argue against a provision expressly included in the heads of terms. RICS will be issuing its model heads of terms later this year.

Even after completing a transaction, heads of terms retain an effect. If a party believes the completed legal documentation has not correctly recorded the parties' contractual intention, it may look to the equitable remedy of rectification. A court would look at any agreed heads of terms as an outward expression of accord between parties.

It always used to be the case that heads of terms would be prepared before they reached lawyers' hands, to outline the principal terms before legal costs were incurred. That situation is changing, however, and it is recommended that solicitors review the heads of terms before they are settled. A legal audit of the agreed terms is valuable to ensure that all points are properly covered.

Perhaps an unintended consequence of this early involvement of lawyers is that some heads of terms are now extending to many pages with detailed formulation. There has to be a proper balance. The heads of terms should provide sufficient detail to preclude the need for further, extended negotiations at the legal stage but they should not be allowed to become a pre-contract proxy conflict between solicitors. Heads of terms should identify and provide the key commercial agreements without such exacting detail as to preclude the transaction moving to its next stage.

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