

The importance of three magic words

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A recent Court of Appeal decision (*Pretoria Energy Company (Chittering) Limited v Blankney Estates Limited*) is a useful reminder of the importance of ensuring that heads of terms for the sale or lease of land are expressly headed “subject to contract”.

Facts of case

The prospective tenant (P) claimed that a binding agreement for lease had been entered into with the landowner (B) for the grant of a 25 year lease of land for the site of an anaerobic digestion plant. Both parties had signed a document called ‘Heads of Terms of Proposed Agreement’ which identified the land, the length of the lease and the annual rent.

The heads of terms were headed “Subject to Full Planning Approval and appropriate consents and easements”. They provided that a formal agreement between the parties would be drawn up within one month of planning permission being obtained and further provided for an exclusivity period during which neither party would negotiate with third parties (both parties accepted that this exclusivity clause was legally binding).

After P obtained planning permission (and after the end of the exclusivity period), B informed P that it had now concluded alternative arrangements with a third party.

Outcome of the case

The Court of Appeal upheld the decision of the High Court that, viewed objectively, the heads of terms were not intended to create legal relations between the parties (meaning a binding agreement for lease had not been entered into). The judges were influenced by the following factors:

1. There would have been no point in having the exclusivity clause if the parties were already bound to enter into a lease.
2. The start date of the lease was uncertain (an ascertainable start date is essential to create a valid lease).
3. A 25 year lease for building an aerobic digestion plant is a complex deal and important terms were missing from the heads of terms that you expect to see if the parties had intended for them to be legally binding (e.g. terms dealing with plant construction, repair, insurance, use, alienation, alterations, forfeiture, planning and environmental controls etc.).
4. The parties intended the lease to be outside the security of tenure regime in the Landlord and Tenant Act 1954, which would not be possible if the heads of terms were legally binding (the contracting out process must be completed before the tenant is contractually bound to take the lease and the parties had not followed that procedure here).

So, given the outcome here, is there anything to be unduly concerned about when drafting heads of terms?

Yes. It would be a mistake to conclude from this case that heads of terms can never be legally binding.

The complex nature of the transaction was a significant factor in this case. However, the judges agreed that, in much simpler transactions (e.g. the freehold sale of an existing property), heads of terms could conclude an enforceable contract for the sale of land where the parties had agreed only the barest of terms, with the court implying terms to fill in any gaps. They also agreed that a statement in heads of

terms that a formal agreement will follow (or words to that effect) does not automatically mean that a preliminary agreement is non-binding (if the formal agreement is simply meant to record, in legal language, what has already been agreed between the parties).

Just calling a document 'Heads of Terms' (or words to that effect) will not, by itself, guarantee that the document will not create a binding contract. The best and most effective way of ensuring that such a document does not show an intention immediately to create legal relations remains, as ever, to include the three magic words – "subject to contract".

That's all very well, but what if some parts of a heads of terms document are intended to be immediately binding (e.g. an exclusivity or confidentiality clause)?

Best advice is to deal with the matter expressly and to make it crystal clear which parts of the document are intended to be immediately binding and which parts are not.

Are there any other requirements that have to be satisfied for a heads of terms document to be legally binding?

Yes (where the transaction is the sale or lease of land). Amongst other things, the document has to be signed by (or on behalf) of both parties. However, a signature does not have to be in traditional wet-ink. For example, simply typing a party's name at the end of a document could, in certain circumstances, amount to a signature.

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