

# All in agreement?

## Don't lose your heads

When parties are able to successfully resolve their dispute at mediation, ideally the agreement should be properly documented to ensure it is legally binding and provides certainty to the parties.

While in many cases this will ultimately result in a formal deed or agreement, parties sometimes choose to enter into an initial 'heads of agreement'-style document for reasons of timing or convenience.

Documenting the settlement in this way may be attractive after a protracted session of mediation, but if the parties intend for the agreement to be immediately binding, particular care needs to be taken to ensure that the documented agreement is properly enforceable.

### Elements of a binding heads of agreement

Determining whether this type of agreement is binding in this context can be broken down into the consideration of two distinct questions:

- whether the essential elements of a contract are present and sufficiently certain, and
- whether the parties intended for the agreement to be immediately binding.

### Certainty of terms

One of the risks of documenting a settlement by way of heads of agreement is that insufficient certainty may be applied to setting out what the parties have actually agreed to.

While courts will attempt to imply terms to give business efficacy to an agreement when appropriate, they will not lend their aid to the enforcement of an incomplete agreement that is no more than an agreement to agree,<sup>1</sup> or an agreement to undertake further negotiation, at some time in the future.

At the very least, it will be necessary for the document to record the parties to it, the critical terms of what has been agreed, and the form of consideration for the agreement.

The extent to which the critical terms are set out is ultimately helpful both to determining whether there is an identifiable agreement capable of being upheld, and also whether the parties intended for it to be immediately binding.

Specifically, it is beneficial for the parties to give as much certainty as possible to the essential terms of an agreement, for example, by ensuring that the agreement addresses the following:

- a. a statement of the issues to be resolved by the agreement (often this can be done by reference to pleadings)
- b. payment terms, including amounts and timing (or a formula to determine these)
- c. a proper description of any items of property (including intellectual property) that are to be dealt with
- d. the extent of any releases or indemnities to be provided
- e. any representations or warranties given by the respective parties, including whether there are any statements that a party is relying on in entering into the agreement
- f. any conditions precedent or subsequent
- g. which party is responsible for any tax liabilities which may arise
- h. confidentiality
- i. what will happen in the event of default
- j. how any court proceedings are to be disposed of
- k. an express statement as to whether the parties intend to be bound by the heads of agreement.

Despite being perhaps the simplest aspect to deal with in preparing the heads of agreement, it is ambiguity in terms of the final point which regularly leads to subsequent disputes, most often in cases when one party subsequently decides that it wishes to resile from the preliminary settlement agreement. Unless great care is taken in properly recording the parties' true intentions, a risk of difficulty and dispute may arise.

### Intention to be bound

The High Court in *Masters v Cameron*<sup>2</sup> laid out the three possible classes of preliminary contract:

1. when the parties have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of those terms, but at the same time propose to have the terms restated in a form which will be fuller or more precise but not different in effect

2. when the parties have completely agreed on all the terms of their bargain and intend no departure from or addition to that which their agreed terms express or imply, but nevertheless have made performance of one or more of the terms conditional on the execution of a formal document
3. when the intention of the parties is not to make a concluded bargain at all, unless and until they execute a formal contract.

The first two scenarios will result in a binding contract, while the third will not.

In the absence of clear and express words demonstrating the parties' intentions, the court must objectively determine these intentions by reference to the terms of the document when read in the light of the surrounding circumstances.<sup>3</sup>

Helpfully, the relevant principles were recently restated in *Lahodiuk v Pace*.<sup>4</sup> In that case, Justice Sackar of the New South Wales Supreme Court held that a heads of agreement entered into following mediation was binding in circumstances when the heads of agreement contemplated the preparation of additional documentation.

In determining whether the parties were bound by the heads of agreement, his Honour considered:

- the parties' intention at the time was the overriding issue, to be determined objectively, having regard to the language of the heads of agreement
- that if the parties intended to be bound immediately, the heads of agreement was binding, even though further documentation was to be prepared
- the heads of agreement must be read in light of the surrounding circumstances, including the history and commercial context of the agreement and that the parties were involved in mediation to resolve litigation
- what a reasonable person in the parties' position would have understood the agreement to mean
- that it was relevant that a heads of agreement was drafted under the supervision of legal practitioners.

In terms of specific language often used in heads of agreement, the Supreme Court of Queensland decision in *Max Reflectance Investment Pty Ltd v Drazcat Pty Ltd*<sup>5</sup>



While resolution is paramount, it can be rendered ineffective by a poorly considered agreement. **Tim Case** and **Suzie Emery** emphasise the critical need to create a document all can rely on.

provides further useful guidance. In that case, Justice Martin confirmed that the use of the words 'subject to a formal deed' demonstrates, prima facie, an intention that the parties will not be bound in the absence of such a "formal deed".<sup>6</sup> This, combined with the fact that when the parties did exchange draft deeds those drafts differed significantly from the heads of agreement, led his Honour to conclude that there was, in fact, no finalised agreement.

However, this should be contrasted with the position in which the specific language used by the parties clearly indicates an intention to be immediately bound. For example, in *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd*<sup>7</sup> Justice McLelland held that the words 'agreement in principle' did not prevail over the clear import of the words 'legally binding'.<sup>8</sup>

## Conclusions

The true nature of a heads of agreement, and whether it is, or is not, intended to constitute a concluded and certain contract, is critical. In disputes of this nature, the parties' very intentions are often the 'decisive issue'.<sup>9</sup>

The magnitude, subject matter or complexities of the transaction are considerations which should ultimately determine whether the parties record their preliminary agreement by way of heads of agreement, or whether they take the time to immediately reduce the settled agreement to a final and formal contract.

This article appears courtesy of the Queensland Law Society Alternative Dispute Resolution Committee. Tim Case is a partner and Suzie Emery is a solicitor at McCullough Robertson.

## Notes

- <sup>1</sup> *Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd* (1982) 149 CLR 600 at 604 (Gibbs CJ, Murphy and Wilson JJ).
- <sup>2</sup> (1954) 91 CLR 353 at 360 (Dixon CJ, McTiernan and Kitto JJ).
- <sup>3</sup> *Godecke v Kirwan* (1973) 129 CLR 629 at 638 (Walsh J).
- <sup>4</sup> [2013] NSWSC 512 (Sackar J).
- <sup>5</sup> [2009] QSC 24 (Martin J).
- <sup>6</sup> [2009] QSC 24 at [17].
- <sup>7</sup> (1986) 40 NSWLR 622 at 628 (McLelland J). Upheld on appeal (1986) 40 NSWLR 631.
- <sup>8</sup> See also *Malago Pty Ltd v AW Engineering Pty Ltd* [2012] NSWCA 227 at [23] where the Court of Appeal (per Macfarlan JA) agreed with the trial judge that the words "without affecting the binding nature of these heads of agreement" were decisive in revealing the intention of the parties to be bound.
- <sup>9</sup> *GR Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd* (1986) 40 NSWLR 631 at 634E (McHugh JA).

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