

A recent case in the New South Wales Court of Appeal has highlighted the need to take care to ensure that preliminary agreements accurately reflect the intention of the parties, having regard to the commercial context and factual matrix in which a transaction takes place.

Preliminary agreements are variously described as heads of agreement, memoranda of understanding, letters of intent and term sheets. In a leasing context, they are often referred to as lease proposals.

*Centuria Property Funds Ltd v Thorn Australia Pty Ltd* [2022] NSWCA 104 involved a dispute as to whether a lessor and lessee had entered into a binding lease.

## Background

1. Centuria Property Funds and Thorn Australia were parties to a heads of agreement that contained an offer by the lessee (Thorn) to enter into a lease with the lessor (Centuria) in respect of commercial premises.
2. The heads of agreement also contained a term permitting the lessee to access the premises prior to commencement of the lease to carry out fitout works.
3. Of significance, the heads of agreement contained a statement that “the lessee and lessor reserve the right to withdraw from and terminate negotiations at any time prior to execution of formal lease documents”.
4. The lease documents were prepared as deeds. The parties negotiated the terms of the lease documents, following which the lessee provided the executed lease (in duplicate) and one copy of the executed incentive deed to the lessor’s lawyers.
5. There was a misunderstanding between the lessor’s and lessee’s lawyers as to whether there would be an exchange of executed counterparts, which was resolved by the lawyers agreeing that duplicate documents were to be executed by the lessee and then sent to the lessor for execution.
6. Duplicate lease documents were provided to the lessor’s lawyers (with the bank guarantee required under the lease). However, there was delay on the part of the lessor in executing the lease documents, apparently due to office access difficulties during the COVID-19 pandemic.
7. From time to time, the lessee was granted early access to the premises to arrange internet and telecommunications connections.
8. Subsequently, and prior to execution of the lease documents by the lessor, the lessee’s lawyers notified the lessor’s lawyers that the lessee was withdrawing from the proposed leasing transaction.
9. The lessor executed the lease documents and advised that it intended to register the lease.
10. The lessee sought and obtained declaratory relief to the effect that it had not entered into a binding lease or agreement for lease with the lessor. The lessor had cross-claimed for declaratory relief to the opposite effect.

## Decision

The primary judge held that:

- The lessor did not “deliver” the lease documents and had not evinced an intention to be immediately bound by the lease documents
- The right for either party to withdraw at any time prior to execution of formal lease documents in the heads of agreement had not been abrogated or abandoned

The Court of Appeal found that:

- The primary judge had not erred in finding that there was no inconsistency between the alternate execution process that the lawyers had agreed and the continuation of the right of either party to withdraw from negotiations
- The primary judge had not erred in finding that the lessee’s request for early access was of little significance in determining whether the lessee had manifested an intention immediately to be bound by the lease documents

The decision of the Court of Appeal has confirmed the effectiveness of “non-binding” provisions in preliminary agreements, even if one party has done everything required of it to show an intention to be bound.

## Commentary

*Centuria Property Funds v Thorn Australia* clearly demonstrates how careful parties need to be when agreeing the terms of a preliminary agreement, particularly as to when the parties are bound to proceed with a transaction.

In circumstances where a lessor is an external trustee, a government agency, or may have a lengthy internal execution certification process, it is not unusual for weeks or months to pass before a lease will be executed by a lessor. In such circumstances, an ill-considered provision in a lease proposal stating that the lessor and lessee are not bound until documents are fully executed, may leave either party bitterly regretting the one that got away.

It's bad enough losing a prospective lessee at any time, particularly in a tight leasing market, but losing one in circumstances similar to those in *Centuria Property Funds v Thorn Australia* is worse.

## Key Contacts



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