Lease negotiations and intention to be bound

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There is often a lot of negotiation that takes place between prospective landlords and tenants before formal documentation (such as an Agreement to Lease) is signed. Whether those negotiations culminate in a binding commitment before an agreement is signed can be a vexed issue. It was of utmost importance to a prospective cinema tenant in a recent High Court case, particularly given they were pipped at the post by a rival cinema operator. *Reading Entertainment Australia Pty Ltd v AMP Capital Shopping Centres Pty*[1] is an illustration of the fine line there can be between 'deal' or 'no deal', and why it is important that parties to negotiations be clear as to their contractual intentions and expectations.

Background

Readings[2] entered discussions with Bayfair[3] in 2015 as to a possible lease by Readings of part of a proposed expansion of the Bayfair Shopping Centre in Mount Maunganui for a cinema complex.

Bayfair issued a request for a proposal in November 2015 stating that key terms would initially be encapsulated in a Heads of Agreement which would be completed in the first quarter of 2016. An Agreement to Lease was targeted for completion in mid 2016. Readings submitted its proposal in December 2015 setting out detailed commercial proposals and attaching a form of Heads of Agreement ('Original HOA'). It was aware that it was one of four operators who had shown a strong interest.

The Original HOA contained a number of conditions (expressed as 'conditions precedent'). They included (amongst others):

- execution of an Agreement to Lease and Lease on terms satisfactory to the lessor and the lessee; and
- both the lessor's and lessee's Boards of Directors' approval.

Negotiations proceeded into mid 2016. In May, Readings emailed Bayfair advising it was willing to 'upgrade' certain aspects of the Original HOA, including the percentage rent formula. Further discussions ensued with Bayfair endeavouring to improve the terms which Readings had put forward. In particular, Bayfair wanted Readings to accept increased occupancy costs and a longer term for the parent company guarantee.

In June 2016 Readings advised Bayfair that its senior management committee had resolved to recommend to their Board to move forward with the project and that an amended Heads of Agreement ('Amended HOA') would be submitted to its board. A few days later Bayfair responded by letter ('the June Letter') advising that, on the basis of Readings' confirmation, it had instructed its solicitors to prepare an Agreement to Lease and lease documentation. Readings' contention was that the June Letter comprised a binding agreement.

By telephone on 4 August 2016 Bayfair advised Readings that a proposed supermarket deal had not been concluded for the Bayfair expansion and that had had

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SCO described Council's Practice Note was not defendable in statutory interpretation terms or as a proper exercise of Council's RMA functions, and the Practice Note should be immediately withdrawn.

The Court has subsequently issued a second interim decision, primarily addressing the nature of the alternative declarations that it intends to make.

The decision will have implications for those with properties either within or adjacent to the SCO. The case also highlights that the Council can make material errors in the interpretation and application of the new AUP.

Upcoming announcement on potential RMA reforms

In our November 2017 article, we noted that neither new Minister for the Environment David Parker nor deputy Eugenie Sage had made any significant announcements regarding the environment portfolio. As a result, we considered that at that time there was a level of uncertainty as to what the 2017 election result would mean for resource management / property development, and the future of the RMA.

Minister Parker has recently advised that he will be making a direct address to the Resource Management Law Association (on 28 March 2018), in which he will set out the Labour Government's environmental policy priorities for the next 12 months. Given their potential importance for those in the property sector, we will provide an analysis of the Minister's policy announcements in the next edition of *The Property Lawyer*. ■

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a big impact on the development plan and programme. Readings' perception was that there was a 'cooling' by Bayfair on the deal at about this time, although negotiations did continue, with Bayfair asking Readings for details about the proposed parent company guarantee and Bayfair seeking to improve the terms so as to reach its required commercial metrics for the development.

In February 2017 Bayfair advised Readings that the cinema deal had been given to one of Readings' competitors. Readings regarded that as a repudiation of the Amended HOA. This was followed by a letter from Readings' solicitors to Bayfair which referred to the Original HOA as an offer, which was said to have been accepted by Bayfair (with the amendments incorporated in the Amended HOA) by the June Letter. Bayfair rejected that there was a binding contract between the parties.

The issues

The issues before the Court to be decided were:

- Whether there was a binding agreement to lease (in the form of the Amended HOA).
- Would it be unconscionable to permit Bayfair to resile from the Amended HOA and was it therefore estopped from denying a commitment to lease?
- Was the June Letter a 'process contract' under which Bayfair was obliged to at least submit a form of agreement to lease to Readings?

Had a binding agreement to lease been formed?

Bayfair argued that Readings could not show that there was any intention by either party to be bound by any contract to lease the premises. It also asserted a lack of certainty of parties, unfulfilled conditions precedent and conduct by Readings which contradicted the proposition that a binding contract had been formed by the June Letter. To the contrary, the June Letter made no explicit acceptance of Readings' offer nor could this be inferred. Bayfair also noted that the parties were sophisticated commercial entities and the nature of this transaction was the type where the Courts would adopt a starting presumption that the parties did not intend to be bound before a formal agreement had been executed. Bayfair also argued that there was no certainty as to the lessor entities Readings was purporting to contract with. Further, there could be no binding contract where conditions precedent for the existence of the contract had not been met (i.e. Board of Directors' approval).

Readings' submission was that, taken together, the Amended HOA and the June Letter contained all the essential terms of an agreement. They relied on the principles in the Court of Appeal decision in *Fletcher Challenge Energy Limited v Electricity Corporation of New Zealand Limited*[4] e.g.:

- The contract is not necessarily legally incomplete merely because consequential matters have been omitted.
- It is the intention of the parties, to be bound or not, which should be paramount.
- The more numerous and significant the areas in respect of which the parties have failed to reach agreement, the slower a Court will be to conclude that they have the requisite contractual intention.
- Provided there is a sufficient framework for determining the undetermined aspects, the Court can 'cure' an omission by implying a term.
- The conduct of the parties after the formation of the alleged contract can be considered to determine if a contract was formed.

The Court regarded the question of whether the parties intended to be bound as paramount. It is only if that stage is reached that the Court will then go on and strive to give effect to that intention by 'filling any gaps' in the parties' agreement.

In determining whether the parties intended to be bound, the Court can look at the words of the agreement, background facts (including statements made by the parties in the course of the negotiations, and any draft contract terms). The Court may also have regard to the parties' conduct after the contract was purported to have been made.[5] If the Court does find, taking a neutral approach, that the parties did intend to enter into a contract, it will do its best to give effect to their intention (despite any omissions or ambiguities). If the negotiations show an 'agreement to agree', the agreement will not be held void for uncertainty if the parties have provided a workable formula or objective standard or machinery (such as arbitration) to determine the matter. It will be a matter of fact and degree in each case whether the gap left by the parties is too wide to be filled. The Court noted commentary in *Law of Contract in New Zealand* that the normal inference in 'subject to contract' cases is that the parties intend their contractual liability to be suspended until a formal contract is signed. However, it will be a question of the parties' deemed intention on the facts as to whether they intend obligations to apply immediately.

The Court considered the 'conditions precedent' that were in the Original HOA and did not consider they were all conditions precedent in the strict sense i.e. that no obligation would arise at all unless and until they were satisfied. However, the Court considered that the Boards of Directors' approval conditions in the Original HOA were intended to be genuine conditions precedent and that no rights or obligations would arise until they had been satisfied. It agreed with Bayfair's submission that, given the nature of the negotiation (pertaining to a very substantial commercial transaction), this was the kind of contract where one would not ordinarily expect the parties to take on legal rights and obligations before a formal document was executed. The Court also regarded the last paragraph of the Original HOA as making it clear that the offer constituted by the Original HOA was in itself intended to be conditional:

> 'The offer contained in this Heads of Agreement is, subject to the conditions of the Heads of Agreement, offered by or on behalf of [Readings].'

In other words, there was no intention to be bound unless and until the Boards had approved the Heads of Agreement.

Was Bayfair estopped from denying an agreement to lease?

Bayfair argued that Readings' estoppel argument must fail essentially for the same reasons the contract claims must fail i.e. there was no basis to show that Bayfair ever committed to an agreement. It argued that Bayfair did not do or say anything to

encourage or create Readings' alleged belief that there was an agreement in place.

Readings argued that the exchange of correspondence gave rise to an expectation that their proposal had been accepted and that it would now be unconscionable for Bayfair to act in a contrary way.

The Court looked at the requirements to establish equitable estoppel e.g.:

- A belief or expectation has been created or encouraged;
- The representation being relied upon was clearly and unequivocally expressed;
- The party alleging the estoppel relied on the representation to its detriment;
- It would be unconscionable for the other party to depart from the belief or expectation.

The Court concluded that the estoppel argument could not succeed and there was no basis for the assertion that the exchange of correspondence gave rise to an expectation on Readings' part. As previously mentioned, the parties' intention to create contractual obligations would only arise upon approval by their respective Boards. To the contrary, the documents showed the intention was that no rights or obligations would exist until the Boards had given their approval. It followed that there was no arguable basis for Readings' estoppel claim.

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Was there a 'process contract' between the parties?

Readings had asserted that the June Letter constituted a 'process contract' under which Bayfair was obliged to at least submit a form of agreement to lease. The process contract was a contract antecedent to any deed of lease (and therefore did not have to comply with Section 24 of the Property Law Act because it did not effect a 'disposition' within that meaning of that Section).

The Court looked at the legal principles applicable to 'process contracts'. In particular, it considered the Court of Appeal decision in *Schulz v McArthur Ridge Investments Limited*[6] where it was noted that it is well established that a contract to negotiate may be enforceable. However, the Court noted that difficulty for Readings with their 'process contract' argument was that even a process contract cannot exist unless and until the parties intend to be bound by such a contract. In this case, the parties did not intend to assume any binding obligations until their Boards had approved the Amended HOA and it was only when that occurred that any obligations, including 'process obligations' would arise. It followed that Readings' 'process contract' argument failed.

Conclusion

The fraught nature of these negotiations and the legal battle that ensued could easily have been avoided had the parties been clear as to their intentions to be bound (or not) at every step of the way. Although Heads of Agreement are sometimes intended to be binding, this is often not the parties' intention and the simple communication of this from one party to another may be all that is required to avoid misunderstandings and consequential disputes. Although it is the presumption in negotiations of significant commercial transactions that the parties do not intend to be bound unless and until formal documentation is signed, a presumption is not always sufficient and it is preferable that this is put out of doubt. All that is required is a communication from one party to the other stating that, to avoid doubt, they do not intend to be bound unless and until a formal agreement to lease is signed. ■

1. [2017] NZHC 2337, 31/10/17
2. Reading Entertainment Australia Pty Limited and Reading New Zealand Limited
3. AMP Capital Shopping Centres Pty Limited, AMP Capital Bayfair Pty Limited and TEL Property Nominees Limited
4. [2002] 2NZLR 433 (CA)
5. Above note 4 at [56]
6. [2015] NZCA 298 at [35]

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