

When do you need a Heads of Terms Agreement?



You need a Heads of Terms Agreement when you have a complicated, detailed project to negotiate and you need to get the main points set down in writing, at the beginning before wasting time and energy negotiating the details in the full contract.

A Heads of Terms Agreement Document, also known as a Memorandum of Understanding (or MOU), is extremely useful to show that the main points are now “agreed” and cannot be renegotiated.

A Heads of Terms Agreement (MOU) is important when you need to:

- 1 Record what are the main critical points of the deal such as price, what is being bought / sold, timescales, conditions to be satisfied and shareholder approvals to be obtained; and/or
- 2 Get those main points signed by the other side so they are “morally” committed; and/or
- 3 Have evidence that those main points are “agreed” so the other side will find it difficult to renegotiate them later on.

Although, if the other side are well advised by their lawyers, it is unlikely that the Heads of Terms will be legally binding, they are extremely useful to show that the main points are now “agreed” and cannot be renegotiated.

If the other side will not negotiate and sign a Heads of Terms document then this it’s likely that they are not serious about your deal, it’s a signal to pull out, you will save time, legal fees and other costs by not proceeding until the agreement is signed.

You need a Heads of Terms Agreement when negotiating complex transitions such as [Joint Ventures](#), Shareholders Agreements, [Business Acquisitions](#), Mergers, Acquisitions and other major Business transactions.

Do you need Heads of Terms Agreement at all?

YES.

Why?

- To stop the back and forwards e-mail trail!
- If the “deal” cannot be written in one simple agreed document, is there actually a “deal”?
- Getting all parties to sign Heads of Terms Agreement – shows from a negotiation point of view that progress is being made! Moral commitment.
- Use it to sell the “deal” to a third party eg other shareholders, bank.
- Tactical advantage for the Seller, because the Buyer is morally committed to proceed. It helps to answer the question in the Seller’s mind “does this person, party really want to buy? Are they serious?”

Note – people use “Heads of Terms”, “Heads of Agreement”, “Memorandum of Understanding”, “MOU” and “Letter of Intent” to mean the same document.

What to put in your Heads of Terms Agreement?

Think about your objective – eg to get all the principle and major points agreed in one document.

- State the principle and defer the detail.
- Take professional advice before making significant concessions (such as on structure, (e.g. share or asset sale) tax or governing law) even where the concession is expressed to be non-legally binding.
- Identify the key conditions to exchange and completion of the contract.
- Road Map to completing Heads of Terms Agreement
- Allocate the main procedural and drafting responsibilities see – Table below

Document	Timescale	Responsibility
1 st Draft Share Purchase Agreement	5 days after signing the Heads of Terms	The Legal Partners
Financial Due Diligence to be finished	21 days after Heads of Terms signed	Accountant

- Acknowledge where appropriate that the heads are not exhaustive.
- Use assumptions where necessary.
- Use a worked example to clarify a formula.

- Make it clear that the Heads of Terms Agreement are not intended to be legally binding (except as otherwise specified).
- Do not let the negotiation of the Heads of Terms Agreement become a full dress rehearsal for the main document.
- Are any provisions intended to be legally binding? Eg confidentiality, exclusivity

Contents of your Heads of Terms Agreement

- The agreed deal:
 - who?
 - what?
 - how?
 - how much?
- Key assumptions on which material issues (such as price) were agreed.
- Principal conditions to exchange of contracts:
 - due diligence (list any specialist reports and investigations required (such as accountants' long form) and which of the Seller's key employees will need to be informed);
 - updated financial information (audited and/or management accounts);
 - buyer's financing;
 - third party consents/agreements;
 - regulatory approvals or tax clearances;
 - board approval;
 - no material adverse change;
 - no material contracts terminated or adversely changed;
 - new service contracts signed by target's key employees;
 - satisfactory restrictive covenants;
 - agreed loan facilities and documentation (if necessary);
 - satisfactory final documentation.
- Principal conditions to completion: Eg board/shareholder approval;

- Statement of any other material issues any party may want recorded and need more detail
- Procedures or timetable for period to exchange of contracts and responsibility for drafting main documents.
- Exclusivity agreement (or refer to separate agreement):
- Allocation of costs in the event the deal does not proceed.
- Confidentiality (or refer to separate agreement)
- Clearly distinguish those provisions in the heads which are intended to be binding (such as the confidentiality and exclusivity provisions, payment of “failure” costs/ governing law)
- Governing law.

If you need more advice once you have read this checklist please contact:

Richard Mullett - 0203 755 5288 / Richard.Mullett@TheLegalPartners.com Always take legal advice from The Legal Partners to get your contracts right.