

June 2006

LETTERS OF INTENT

INTRODUCTION

As a regular user of Letters of Intent and Memorandums of Understanding (“MOUs”), I want to share my thoughts with you about the risks and benefits of their use. Without a good understanding of the issue, MOUs can have some unexpected results.

PURPOSE

The main purpose, and the benefit of the MOU is to crystallise and to capture the commercial intentions of the parties so that:

the principals can proceed with a degree of confidence that they have “struck a deal”; and
the lawyers can translate the MOU into detailed legal documents to give full legal effect to the intention of the parties.

Sometimes, the parties become so caught up in the details of the MOU that the time and cost involved becomes counterproductive. In that case, one may as well proceed directly to legal documentation.

WHAT EFFECT DOES THE MOU HAVE?

It is critical for the parties (and their advisers) to be absolutely clear about the intended effect of the MOU. Do they want to be legally bound or not? Is the MOU to serve as a non-binding commercial document, or is to tie the parties legally, even though it may lack some of the details to be found in a formal legal contract.

Surprisingly, there are many cases where this critical issue has been left unresolved and it has fallen to the courts to decide whether the parties are bound or not.

Uncertainty is the worst of all situations and it is worth making every effort to avoid this outcome.

THE APPROACH OF THE COURTS

If the courts have to decide whether or not the parties are legally bound by the MOU, then the following are some of the factors which will determine the outcome:

what did the parties INTEND having regard to the surrounding circumstances including their conduct (and also part performance of the contract) – not only the words of the MOU;

is there sufficient certainty as to the essential provisions – even if other provisions are unclear or unresolved (and perhaps not even addressed);

if the court thinks that there was an intention to be bound then they will generally seek to “uphold the bargain”, that is to treat the MOU as binding. The test is an objective one. The intentions of the parties are ascertained from the documents and the surrounding circumstances and conduct.

Despite the informality of the MOU, it can have very real consequences in the wrong hands. Results that may not be welcome!



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CHOOSING BETWEEN BINDING AND NON-BINDING MOU

Most often, the parties prefer not to be legally bound by the MOU, relying on it rather as an indication of their commercial intentions. Concise language is required to put beyond doubt the intention of the parties not to be bound.

There are however circumstances where the parties do wish to be bound. In that case, it is equally important to have a clear statement of intention to be bound. It is also useful to identify unresolved issues and to spell out how to resolve these matters. In almost every case, this will be achieved by negotiations between the parties. However this can fail. The only effective way of ensuring a balanced fully fledged legal document, is to have recourse to a third party expert. Proper provision needs to be made for this in the MOU.

Sometimes the parties wish the MOU to be non-binding but to include specific clauses which are binding. Examples are confidentiality provisions, "no shop" clauses and provisions to deal with costs. Once again clarity of intention is the order of the day.

IMPACT ON NEGOTIATIONS

The MOU is likely to have an impact on the ongoing negotiations. However, it should not serve as a tool to preclude proper discussion or to lock in unfair outcomes. To ensure that this is the case, it is worthwhile making it clear that the parties are at liberty, acting in good faith, to freely discuss the MOU and, where appropriate, to introduce additional/different matter for the purpose of the legal agreement.

CONCLUSIONS

I favour using an MOU to establish a clear basis on which to proceed. However:

- be clear and specify whether you wish to be bound or not;
- if you want to be bound, incorporate appropriate deadlock breaking mechanisms in case the discussions break down over the details;
- treat the MOU with respect, and do not let the tail wag the dog;
- at all costs, avoid the worst outcome of a dispute about the status of the MOU itself!

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