

Getting your head around ‘heads of agreement’



What are Heads of Agreement?

Also referred to as Heads of Terms, Letter of Intent or Memorandum of Understanding, the purpose of this document is to set out the principal terms agreed between the parties; to record what the parties have “shaken hands” on.

Are Heads of Agreement binding?

Generally speaking, unless an obligation is expressed to be binding, the terms set out in Heads of Agreement will not be legally binding. They are the precursor to a detailed sale and purchase agreement in which the rights and obligations of the parties are intended to be legally binding. However, whilst Heads of Agreement do not legally compel either party to conclude a deal on the terms set out in the document (or in any capacity at all), it does evidence a serious intent to enact the deal on those terms. From a moral perspective, it is sometimes difficult to reverse from a position set out in the Heads.

Why use Heads of Agreement?

Commercial transactions are often complex, time-consuming, at times stressful and usually always costly for both the seller and the buyer. Therefore, before fully committing to a transaction, each party will want assurances that the other party shares the same intentions.

Despite not being legally enforceable in its entirety, a well-drawn set of Heads of Agreement should give the parties the desired assurance that the other party ultimately wishes to complete on the key terms set out in the

Heads.

Heads of Agreement can also be useful as the transaction progresses, by acting as a frame of reference to be adhered to by the parties and their advisors. Moreover, as it is not “written in stone”, the Heads allow for a degree of flexibility when practical factors impact the original timeline and structure of the transaction.

What to include in Heads of Agreement?

Where a business is being sold, key terms you would expect to find addressed in a set of Heads include:

- the purchase price for the business and how it will be satisfied;
- if the business trades from a property which it owns, whether it will be included as part of the transaction or kept by the sellers;
- if the purchase price is to be paid in full at completion or whether a portion of it is to be held back for a period and, if so, the period for which it will be withheld and the conditions for its release;
- if the current owners are to leave or remain in the business to assist with a handover;
- if the buyer wants to include warranty and indemnity protections in the sale and purchase agreement; and
- if the buyer will be given a period of exclusivity when the business will be taken off the market.

What terms are typically expressed to be legally binding?

There are some components of the Heads of Agreement that are commonly expressed as binding on the parties. These include:

- an obligation on the parties to keep the content of the Heads of Agreement confidential; and
- an obligation on the sellers to discontinue discussions with third parties and to stop marketing the business for sale for an agreed period (exclusivity).

Are they worth it?

Heads of Agreement are often advisable in the preliminary stages of a commercial transaction, particularly more complex transactions. After a period of negotiation, a well-drawn set of Heads of Agreement will document the principal terms of the transaction agreed by the parties and which are intended to guide their lawyers and other professional advisors as to what the parties want from the deal. This will hopefully avoid delays and help the parties manage the professional costs and expenses.



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