

Update: 2 May 2007 Preliminary agreements - To bind or not to bind?



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Summary

The usefulness of preliminary agreements in a commercial transaction is often undermined by uncertainty about whether they are binding on the parties or just record intentions without being enforceable.

What are preliminary agreements?

Whether called a letter of offer, letter of intent, heads of agreement, memorandum of understanding or anything else, a preliminary agreement is entered into with an intention to conclude a more comprehensive agreement at a later date.

Legally there are only two types: those that are binding when signed and those that are not.

What are the benefits?

Preliminary agreements are a common and valuable part of commercial practice. They are used for different reasons, but motivations often include:

- Showing the commitment of parties to the transaction
- Expressing commercial terms of an agreement in simple and clear language
- Giving a party exclusivity on a deal
- Recording confidentiality obligations

- Forming a contractual bulwark, so that if negotiations become strained, at least that much is agreed and recorded.

What are the problems?

Problems with preliminary agreements arise when one party doesn't want to proceed with the transaction and the other does. The question is whether there is a binding, enforceable contract.

This usually involves two issues: whether there was **intention** to be bound and whether the preliminary agreement is sufficiently **certain** to be enforceable.

How can Fleming Muntz help?

All preliminary agreements should contain a clear statement as to whether the parties intend it to be legally enforceable, or whether they sign just to show moral commitment.

Fleming Muntz has experienced business lawyers who can prepare a document that fits the parties' commercial needs, whether binding or not.

Important fine print

This update is for general information only. It is not a complete guide to the area of law. Competent advice should be obtained before taking any action.

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