

MOUs: to Bind or Not to Bind?

No matter the commercial collaboration or transaction envisaged, whether it is the establishment of a school, company, appointment of a franchisee, distributor, agent, or service provider etc., it is prudent for contracting parties to agree on the high-level terms, which will form the basis of the final form agreement(s), in writing, at an early stage. Doing so assists the parties in thrashing out the key issues upfront, as well as guiding the lawyers when drafting the final form agreements. These types of preliminary documents that capture the key terms between parties, pending negotiation and agreement on the definitive agreement(s), are often referred to as letters of intent, heads of terms or memoranda of understanding (which are individually referred to below as a 'MOU').

A MOU is not intended to be the final agreement between the parties on the subject matter at hand, nor is it intended to contain all the relevant detailed terms of the transaction, but rather, it gives reassurance to the parties involved that there is a genuine interest, on both sides of the transaction, to collaborate exclusively in progressing matters to a stage whereby definitive final form agreement(s) can be agreed and signed between the parties. In addition, negotiation of a MOU can help identify, clarify and resolve any points of contention between the parties at the outset, which will ultimately facilitate the efficient and cost-effective negotiations of the final form agreement(s). Put simply, if the parties cannot agree on the high-level terms in a MOU, then it is, perhaps, unlikely that any proposed collaboration in relation to the contemplated transaction will materialise.

What should be in a MOU?

Think of a MOU as a foundation upon which the parties will lay the bricks forming the final form agreement(s). Depending on the subject matter of a MOU, the content will vary; however, ideally, the key substantive terms of the transaction should be set out and agreed in principle, for example, the financial terms, payment terms, duration, risk allocation, delivery terms, governing law and dispute resolution forum etc. Additionally, a MOU can also detail certain terms yet to be agreed, which can help focus and structure further negotiations between the parties, post execution of the MOU.

Binding or Not?

Before parties enter into a MOU, a decision should be made as to which provisions they want to be legally binding between themselves and which are not intended to be legally binding. It is imperative that the parties are in agreement in this regard, as any ambiguity can lead to the parties inadvertently being contractually bound to certain terms of the MOU which were still intended to be further negotiated.

Under Article 125 of the UAE Civil Transactions Code No. 5 of 1985 (as amended) (the 'UAE Civil Code') a contract is defined as "...the coming together of an offer made by one of the contracting parties with the acceptance of the other, together with the agreement of them both in such a manner as to determine the effect thereof on the subject matter of the contract, and from which results an obligation upon each of them with regard to that which each is bound to do for the other..."

Additionally, Article 141 of the UAE Civil Code provides that "...a contract may only be made upon the agreement of the two parties to the essential elements of the obligation, and the other lawful conditions which the parties regard as essential..." and

“...If the parties agree on the essential elements of the obligation and the remainder of the other lawful conditions which both parties regard as essential and they leave matters of detail to be agreed upon afterwards but they do not stipulate that the contract shall not be regarded as made in the event of absence of agreement upon such matters, the contract shall be deemed to have been made, and if a dispute arises as to the matters which have not been agreed upon, the judge shall adjudicate thereon in accordance with the nature of the transaction and the provisions of the law...”.

As the UAE Civil Code does not define what the “essential” elements of a contract are, there is a risk that where the parties have, in principle, agreed on a number of elements that they regard as “essential”, the parties could unintentionally find themselves legally bound to all the terms of a MOU, unless they expressly state which terms are not legally binding as between themselves.

More often than not, parties will want, at least, certain provisions of a MOU to be legally binding, but not all, hence it is important that the parties pay attention and make it clear which terms of a MOU are to be binding and which are not.

Examples of Provisions of a MOU that are Commonly Binding or Non-binding:

BINDING	NOT BINDING
<p>1. Governing Law and Dispute Resolution.</p> <p>The parties should have certainty on the governing law and dispute resolution provisions, in the event of a dispute arising under the MOU.</p> <p>Another consideration to bear in mind when deciding on a dispute resolution forum is "enforceability". How easy is it going to be to enforce a favourable judgment or arbitral award against the other party?</p>	<p>1. The Intended Transaction/Collaboration/Appointment</p> <p>Although there should be a general outline of what the parties are intending to do, the parties should avoid 'setting in stone' the detail in respect thereof at this stage. For example, in the context of a joint venture arrangement, the parties may eventually agree on a different shareholding or capital contribution and hence, any term in the MOU which addresses this topic should not be legally binding.</p>
<p>2. Costs</p> <p>There should, ideally, be prior agreement on who is to bear the costs incurred in respect of the negotiations of the MOU. More often than not the parties agree to cover their own costs, but in the event that one party agrees to pay the other party's costs then, of course, that should be a binding obligation on that party.</p>	<p>2. Commercial Terms</p> <p>It is useful for the parties to reach provisional agreement on any commercial matters, e.g. purchase price (in the context of a transaction) or product prices/royalty payments (in the context of a distribution or franchise agreement, respectively). However, several factors may influence the initial understanding between the parties, as negotiations unfold, such that the parties should avoid being contractually bound to certain figures upfront, and hence, these type of terms in a MOU would normally not be legally binding.</p>
<p>3. Confidentiality</p> <p>Usually, as part of the negotiations, there will be information of a confidential nature disclosed between the parties and hence, there should be binding confidentiality and non-disclosure obligations imposed on both parties in order to protect against unauthorised disclosure to third parties. Therefore, these types of confidentiality and non-disclosure terms in MOUs are legally binding in order to protect both parties from the moment the MOU is signed.</p>	<p>3. Condition Precedent</p> <p>Based on the subject matter of a MOU, there may be certain conditions that the parties envisage having to satisfy at the outset in order to effect the contemplated transaction or commence any intended collaboration.</p> <p>However, these conditions may become irrelevant and/or require further amendment, as negotiations progress, therefore the parties would not wish to find themselves bound to a specific set of conditions agreed at the outset. Accordingly, these types of conditions in a MOU should not be legally binding in a MOU.</p>
<p>4. Exclusivity Provisions</p> <p>It is not uncommon for parties to agree on an "exclusivity period", whereby each party agrees to cease any negotiations and/or agrees not to enter into any arrangements, directly or indirectly, with a third party in relation to the subject matter of the MOU for a set period of time, thereby granting the parties to the MOU an exclusive period within which they are both bound to negotiate with each other, only, with a view to concluding the final form agreement(s) in respect of the subject matter of the MOU.</p> <p>The parties to a MOU would generally wish to ensure that these exclusivity provisions are legally binding and that, in the event of a breach, they would be able to pursue any potential damages claim.</p>	<p>4. Timetable</p> <p>It is always useful to agree on a rough timeline of events in order to achieve the desired result, but this again could be impacted upon by numerous external influencing factors. Therefore, any timetable specified in a MOU should be indicative only and not legally binding.</p>
<p>5. Duration</p> <p>The duration of the MOU should be clearly defined and there should be a specific date by which the MOU will cease to have effect. This date is often referred to as a "Drop Dead Date" or "Long Stop Date" and is the date by which the parties should have entered into the final form agreement(s) effecting the subject matter of the MOU.</p>	
<p>6. Limitation of Liability</p> <p>Parties may wish to agree to limit their respective liability under a MOU (e.g. the parties often agree to exclude any direct, indirect, consequential or incidental losses, which may be suffered or incurred or arise from any failure by either party to enter into definitive agreements) and hence, these terms should be legally binding in any MOU to ensure that the parties are protected as intended.</p>	

Summary

MOUs can be useful in focusing preliminary discussions between the parties, detailing the high-level terms upon which the parties have provisionally agreed and setting the framework within which the parties will collaborate in order to conclude the binding final form agreement(s).

Importantly, care should be taken to ensure that any MOU clearly records that, apart from those matters expressly agreed to be legally binding, each party regards the remaining terms of a MOU as non-binding so that the parties are able to avoid being unintentionally bound to terms which were intended to remain open for further negotiation.

As can be seen from the above, MOUs could have unintended consequences for parties hence, legal advice should always be sought when entering into any MOU in order to avoid any unintended consequences potentially arising, which may not be immediately apparent or appreciated by the contracting parties at the time of signing.

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