

What's in a Terms Sheet?

The importance of pre-contractual documents



It sounds paradoxical that a pre-contractual document which has no legal effect can be as important as the subsequent contract itself. However, setting out the commercial parameters of a transaction in a Terms Sheet can do more than focus the parties' minds.

A Terms Sheet (and its equivalents such as a Heads of Agreement, Memorandum of Understanding or Letter of Intent) is a short, relatively informal document in which the parties set out the main aspects of their proposed relationship. Once the Terms Sheet is signed, the parties will negotiate the terms of a formal legal document containing detailed provisions governing all aspects of the deal.

In most cases, Terms Sheets are expressly stated to be non-binding so that the parties can walk away from the negotiations at any stage. However, even if a Terms Sheet is not legally binding it is important to get the contents right. The subsequent formal contract will reflect the provisions in the Terms Sheet, and after committing to something (if only on paper and not before the law) it will be difficult for a party to justify going back on its word.

Sometimes, Terms Sheets go one step further and provide that, while most of the provisions

are non-binding, some of the clauses are intended to have legal effect. This allows the parties to still be able to walk away unscathed if the subsequent negotiations fail, while providing comfort in certain areas. The clauses intended to have legal effect commonly contain confidentiality obligations, obligations to negotiate with the other party in good faith for a certain period, restrictions on simultaneously negotiating similar deals with third parties, and occasionally even obligations to pay a non-refundable fee in return for the exclusive negotiation period.

Occasionally, Terms Sheets are intended to be legally binding, in which case they will need to contain a lot more detail and touch on almost all aspects of the proposed transaction. There is a danger with binding Terms Sheets that they do not contain enough information so as to be sufficiently certain to be legally enforceable. For example, an agreement by a party to grant a licence to the other party in return for a royalty rate to be agreed will only amount to an 'agreement to agree' rather than an agreement to actually grant the licence as one of the main elements of the parties' bargain is left undecided. Specifying a mechanism for determining the royalty rate may help overcome this problem, such as by providing that the parties are to have regard to certain criteria when negotiating the royalty rate, and that if they fail to agree, the issue will be determined by an expert.

A Terms Sheet gives the parties the opportunity to:

- > focus on the primary commercial aspects of the deal and reach agreement in principle on the issues that are most important to them without having to consider every detail;
- > identify potential deal breakers early on in the negotiations before any significant legal costs have been incurred;
- > obtain a certain level of commitment from each other before proceeding to the next step, even if it is likely that 'commitment' is not enforceable;

- > secure rights to a particular technology or other asset where government funding or a third party investment is depending on such rights, as a way to satisfy that condition relatively quickly and cheaply; and
- > have the key elements of the transaction set out in writing (whether or not legally binding) making it considerably easier to both draw up and negotiate the subsequent formal legal contract.

A Terms Sheet can be an invaluable tool to progress negotiations, but it needs to be prepared with care in order to avoid making any unintended commitments. Think of a Terms Sheet not as an alternative to a formal legal contract, but rather a stepping stone towards it.



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