

CORPORATE KNOW-HOW

# HEADS OF TERMS: THE BASICS



## WHAT DO YOU NEED TO KNOW?

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## WHAT IS IT?

In this guide we will look at heads of terms as they relate to the sale of a business or assets in England & Wales. Whether identified as “heads of terms”, a “letter of intent” or “heads of agreement”, these documents summarise the key terms of a proposed transaction. They are intended to be brief so that they can be approved at the outset of negotiations, thereby enabling the parties to move forward with some comfort that the main terms are agreed (at least in principle). Heads of terms can also be a helpful way of setting out the transaction timetable, such as when the seller should provide access to information within a data room, when the buyer should aim to complete their due diligence or a target date for completion.

### Do I need them?

Agreeing heads of terms is not a legal requirement for commercial or corporate transactions and, in some situations, may not be considered necessary or desirable by the parties. Nevertheless, they are a common feature in corporate transactions as alignment on key terms, such as how information should be shared and conditions for the negotiation period (i.e. confidentiality and exclusivity) can help to ensure a smoother transaction process. In addition, fleshing out the key terms of a purchase offer early on can help identify points of contention that should be addressed before significant expense is incurred.

### What does exclusivity mean?

Exclusivity is a legally binding commitment between the parties to exclude third parties from entering into discussions in respect of the proposed transaction. It is intended to prevent either party from committing time and costs to a process that the other party then abandons in favour of an alternative opportunity. The standard objective of an exclusivity provision is to ensure a seller does not pursue alternative offers while supposedly engaged in good faith negotiations with a prospective buyer.

For the seller, an exclusivity provision can be drafted to prevent a buyer from pursuing multiple businesses in the same sector at once, ensuring they focus their efforts on one transaction. A period of exclusivity can be a good way to encourage progress on a transaction within a certain timeframe, while allowing either party to walk away if certain milestones have not been reached.

### Do I need a non-disclosure agreement (NDA) as well?

If a separate NDA has not been agreed prior to finalising heads of terms, legally binding confidentiality provisions can be included within the heads of terms. This is particularly appropriate for transactions that are not anticipated to involve the sharing of substantial confidential information, where short form, legally enforceable confidentiality provisions within the heads of terms may well be sufficient to give the parties comfort. In situations where highly sensitive information is to be disclosed, it may be more appropriate to agree a separate, long form NDA that sets out the information to be shared and contains detailed restrictions on who can view/access such information.

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### What if the deal terms change?

The legally binding elements of heads of terms are usually limited to obligations around exclusivity, confidentiality and liability for costs as opposed to the commercial terms around purchase price, payment structure or connected employment arrangements. Most heads of terms therefore do not restrict the parties from agreeing alterations to the purchase offer, although re-opening agreed terms without adequate cause can be seen as acting in bad faith. Nevertheless, heads of terms are usually agreed at the outset of a transaction and there is the potential for information disclosed by the seller or a change in market conditions to cause the initial commercial terms to no longer be appropriate or reasonable, so renegotiations may be appropriate.

### How do I enforce them?

If either party breaches the legally binding provisions, enforcement would usually be pursued by way of a breach of contract claim through the courts, unless the heads of terms contained a binding commitment to use a method of alternative dispute resolution, such as arbitration or mediation. In some circumstances, it may also be appropriate to take further enforcement action, such as obtaining an injunction to prevent the disclosure or misuse of confidential information disclosed in the process so far. Like many commercial agreements, the strength of enforcement provisions within the heads of terms are constrained by the balance of power (or funds) between the parties and willingness to pursue a claim. Therefore, it is important to consider the situations likely to arise and what the best case rectification looks like – which should help ensure enforcement options are relevant and useful.

### How do I terminate them?

As heads of agreement are usually (other than as described above) non-binding, if either party no longer wishes to continue with the project, it can simply cease negotiations in relation to those areas which usually are binding:

- (a) An appropriate duration for confidentiality obligations to remain in place following the end of negotiations depends on the commercial sensitivity of the information shared along with the damage that could be done to the market standing of a business identified as up for sale.
- (b) Exclusivity provisions should be agreed to fall away immediately on the end of negotiations in order to ensure that the seller is able to pursue discussions with other potential purchasers without delay.

It is important to ensure that withdrawing from the process does not breach any of the legally binding aspects of the heads of terms – whether that be returning/destroying confidential information or carefully timing approaches to any new parties that may risk triggering the exclusivity provisions.

### Conclusion

Whether heads of terms are useful or desirable in respect of a transaction depends on the circumstances. Some parties may feel their energies are better focussed on progressing due diligence and drafting the actual transaction documents or may have concerns about notification requirements and the legal implications of agreeing commercial terms (even largely non-binding ones) early in the process. If they are used, heads of terms are highly flexible in respect of how lengthy and complex they can be, allowing for a variety of forms to suit the preference of the parties. Provided that those involved are aligned on the broad terms of the transaction, agreeing a form for signing should not pose a significant hurdle to progressing discussions and should instead help establish a foundation of trust and good faith to move forward.

## HEADS OF TERMS: **THE BASICS**

Whether you are considering selling a business, buying a business or advising someone who is, our specialist Corporate lawyers would be happy to provide you with the support you need at any stage in the process.



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