



Trench & Associates DMCC

Legal Consultants

Dubai

Are Heads of Terms binding? How do the laws of the UAE interpret them?

'Heads of Terms' are a written agreement which detail the parameters of a business transaction or a potential one, where the parties have reached an understanding regarding the process or general outline of a particular transaction. They are usually intended to formalise the initial understanding reached between the parties before the transaction proceeds, and are commonly used in corporate and commercial transactions, including share transfers, joint ventures, private equity investments, and financing transactions.

Generally speaking, Head of Terms are usually intended to be non-binding, as they are not intended to have legal effect on the parties involved, but rather simply aim to put the position of the parties with regards to the intended transaction in writing. A term sheet, Memorandum of Understanding (MOU) and a letter of intent (LOI) are all versions of Heads of Terms.

However, under the laws of the United Arab Emirates (UAE), any Heads of Terms can be deemed legally binding if, unless it is expressly stated otherwise, especially if the parties have agreed certain essential terms to the transaction.

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 generally, all terms will be regarded as essential unless it is specified otherwise, as it is not clearly defined in the Civil Code which terms would be regarded as “essential”.

As a result, the Courts may infer that the entire Heads of Terms are binding if they consider that essential elements of the transaction have been agreed. Therefore, parties should consider whether they wish for certain terms of Heads of Terms not to be binding or non-binding before they enter into a transaction, and if so, this should be clearly specified.

Further, Article 257 of the UAE Civil Code [i] states that “the basic principles in contracts are the consent of the contracting party or parties and the obligation(s) they have agreed to as set out in the contract”.

In an infamous case heard in 2011, seen in front of the Dubai Courts, National Bank of Umm Al Quwain (the Bank) v. Global Investment House, it was considered that Clause 3 of that particular MOU stated that the Bank and the Global Investment House (GIH) should conclude a subscription agreement only once the Bank completes all formalities and legal

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matters preceding that agreement. The Court of Appeal found that "if the wording of a contract is clear, the courts should not depart from it by way of interpretation to ascertain the intention of the parties. It is important that the negotiations produce an agreement containing the essential terms of the contract." The Court upheld the MOU to be binding, stating that Clause 3 of the MOU contain a clear wording of the parties' intention and agreement and that they should not depart from it. It is also worth noting that the UAE law places an emphasis on the concept of parties acting in good faith and will generally interpret any contract in light of whether it would be considered acting in good faith for parties to go back on their earlier word.

Certain elements of Heads of Terms which parties may commonly wish to be binding can include governing law, jurisdiction clauses, exclusivity provisions, limitations of liability and confidentiality. Common terms which the parties may not wish to be binding include but are not limited to commercial terms, the timetable of the transaction, and certain conditions precedent which may need to be revised throughout the envisioned transaction. The Heads of Terms should essentially be viewed as the foundation which lays out the transaction, however, should generally be treated as a starting point, rather than formalising the entire transaction.

Whilst an individual without a legal background may believe their obligations are not enforceable under the Heads of Terms and they are just at the initial stage of a transaction, they do legally set a transaction in motion and certain parties treat these terms as set in stone. Heads of Terms provide a framework to negotiate a final contract however they cannot be merely disregarded as their binding provisions do hold legal importance that both parties should consider.

In conclusion, while the default position under the laws of the UAE would be that the entire documents of the Heads of Terms would be binding, unless expressly stated otherwise. Heads of Terms are generally useful in setting out the framework of a transaction to be entered into and should be treated as such. Any party entering into Heads of Terms should carefully consider which of the points they would like to be binding accordingly, and it should be clearly stated that only those terms which the parties wish to be binding will actually be binding and the other terms would be non-binding to retain a scope of development of the transaction.

Further, it is strongly recommended that any parties seek legal advice before entering into any Heads of Terms.

Please do not hesitate to contact us should you require any assistance in this regard.

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