

IT BYTES

ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

WHAT IS THE DIFFERENCE BETWEEN A 'BINDING' AND A 'NON-BINDING' MEMORANDUM OF UNDERSTANDING?



WHEN DOES THIS QUESTION TEND TO ARISE?

A memorandum of understanding or 'MOU' can serve as a useful tool to crystallise the key terms of a transaction in circumstances where some finer details still need to be worked through or where the parties may for other reasons simply not (yet) be ready to enter into a formal contract. In particular, an MOU can help the parties to ensure they are 'on the same page' before investing time and effort in negotiating a formal contract. In some cases, the parties may intend to be bound by and may even start work in reliance on the terms of the MOU, before a formal contract has been concluded. In other cases, the MOU will simply be intended as a non-binding statement of intent. The precise characterisation of the MOU becomes important if things break down and one party feels aggrieved by a promise in the MOU that they believe has been broken. The enforceability of the MOU as a contract will then become a key issue.

WHAT DOES THE LAW SAY?

Determining whether an agreement is binding as a contract will often depend on whether, based on an objective assessment, the parties intended to enter into a legally binding agreement. In considering whether the parties had the requisite intention, the court will consider the language of the document, as well as its context. Relevant context might include the conduct of the parties at the time the document was entered into and the relationship of the parties generally.

Where it is apparent from the context that the MOU was to be followed by a formal contract, it can be particularly difficult to determine whether the parties intended for the MOU itself to be legally binding. Based on the High Court authority in *Masters v Cameron* (1954) 91 CLR 353, if an MOU includes language to the effect that the MOU is intended to be 'subject to contract' then it will fall within one of the following three categories:

If an MOU falls into one of the first two categories, the parties are considered to have entered into a legally binding agreement. Accordingly, an aggrieved party may be able to bring a claim in contract seeking damages if the other party fails to comply with the MOU. On the other hand, if an MOU is found to fall into the third category, then there is no binding agreement and, therefore, there can be no claim in contract if there is a failure to comply.

Determining which of these categories an MOU falls into requires an objective assessment, based on what a reasonable person would have considered the intention of the parties to be on entering the MOU at the time in the relevant context.

1

EXECUTION OF THE CONTRACT IS A MERE FORMALITY

The parties intend on being immediately bound by the terms of the MOU, but also intend in due course to restate their agreement in a more complete or precise manner through a formal contract

2

EXECUTION OF THE CONTRACT IS A CONDITION PRECEDENT TO THE OBLIGATION TO PERFORM

The parties have reached a concluded bargain and do not intend to depart from the terms of the MOU, but have made performance of one or more of the terms of their bargain conditional upon the execution a formal contract

3

EXECUTION OF THE CONTRACT IS A CONDITION PRECEDENT TO FORMATION OF A BINDING CONTRACT

The parties do not intend to be bound by the terms of the MOU unless and until a formal contract is executed



WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

If entering into an MOU, consider whether it is in your interests for the MOU to be immediately binding. If not, then you should include an express term in the MOU which states that it is not intended to be legally binding (possibly with the exception of some limited aspects, such as confidentiality provisions, in order to protect any ongoing negotiations).

On the other hand, if you do wish for the MOU to be binding, then you should include an express statement to that effect and ensure that other requirements to form a binding contract have been satisfied – e.g. that the terms are sufficiently certain and that there is supporting consideration from both parties. You should also take care to ensure that the MOU includes any relevant conditions you wish to apply in relation to the development of the formal contract. For example, you could include a termination right if a formal contract is not concluded by a set date – that can be a useful tool to ensure the parties remain focussed on completing negotiations and finalising the formal contract.

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