



Agreement Frameworks: What to use?

This article focuses on the different types of agreements available and explores the situations where one agreement is used over another. It also explores the element of intention to enter into an agreement through being clear as to whether the documentation is meant to be contractually binding or not.

Parties wishing to form a contractual relationship tend to enter into one of the following documents/agreements:

Non-legally Binding

- a) **Letters of Intent:** This document expresses an intention to enter into a binding contract, outlines the major terms of a contract, but is not binding in itself unless it expressly states the intention to be binding on certain preliminary points e.g. confidentiality.
- b) **Memorandum of Understanding (“MOU”):** An MOU expresses an intention to perform certain obligations, but with a clear statement that it is not contractually binding on the parties. Essentially an MOU is the affirmation of a professional relationship between the parties. It is common for government departments to enter into MOUs with each other because government departments are not always legal entities in their own right.
- c) **Heads of Agreement:** Such a document can be either binding or non-binding. It usually sets out the key terms of a binding contract, even though a more formal and detailed document is expected to be completed at a later stage. Often these types of agreements are dependent on the execution of a further document and are commonly used as part of the process of negotiating commercial transactions e.g. the purchase of a business.

It is extremely important, then, to be clear about whether the document being utilised is meant to be contractually binding or not. Under contract law the required intention is not the actual intention of the parties but the objective intention gained from the document itself – that is, what is independently understood from the document.

Despite the descriptions and intended use of various documents between parties, contested cases have been decided either way due to the courts being required to engage in lengthy examinations of the correspondence and negotiations leading up to the creation of the document.

Legally Binding

- d) **Contract:** Basically, a contract must contain the following elements:
 - i. **agreement:** offer and acceptance;
 - ii. consideration – for example, the payment of money to receive certain goods; and
 - iii. intention to be legally bound.
- e) **Deed:** Deeds are traditional instruments for transferring property and creating obligations on a natural person or company. Such a document obtains its binding force from its form alone – that is, how it is actually written. At common law, for an instrument to be a deed, the parties must comply with certain formalities, such as:
 - i. it must be in writing;
 - ii. a personal seal is placed on the document; and
 - iii. it is to be delivered to the counter party.



In contrast with a contract, there is no requirement to provide consideration for a deed to be enforceable at law i.e. agreements can be enforceable if they are supported by consideration (in the case of contracts) or if they are given under seal (as with deeds). Therefore, parties should enter into a deed rather than a contract where there are doubts about consideration flowing from the parties.

Deeds also provide further benefits such as:

- a) longer limitation periods of 12 years during which time a party can commence proceedings compared to 3 years for a contract; and
- b) providing solutions to overcome the privity rule, being a rule which states that a person who is not a party to a contract cannot benefit from stipulations contained within that contract. For example, this may occur in situations where a financial guarantee or letter of credit is to be provided.

Conclusion

When parties intend to enter into a contractual relationship there are a number of documents which will allow them to plan, negotiate and outline the essential terms by which they wish to be bound to. These include Letters of Intent, Memorandum of Understanding and Heads of Agreement.

When it is determined that a binding agreement is to be entered, the parties must consider whether or not a contract or a deed is most desirable. The key difference between a contract and a deed is that a deed does not need consideration – it is an instrument that indicates an individual's most sincere promise to do something that she or he has agreed to do.

For advice on agreements and deeds, please contact Bowden McCormack on 08 8941 6355 or email the writer at michael@bowden-mccormack.com.au.