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Corporate Law

## Buying & Selling a Business – Why I need a Head of Terms



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## What are they?

The initial agreement of a purchase price for a business is often substantially more complicated than £X in cash for the business with no other obligations or expectations between the parties. Heads of Terms are effectively a short summary of the deal terms agreed at the outset of the sale so that all parties are aware of what the end goal is – even if there might be some scope for changes along the way. This short guide sets out some key considerations in respect of using Heads of Terms when buying or selling a business, however, if you would like further detail please do not hesitate to contact us.

## Why should I use them?

Heads of Terms are not essential to any transaction, however, some of the key reasons for their usefulness are set out below:

- **Good faith:** Agreeing terms at the outset is usually an indication that both parties are acting in good faith to follow the terms agreed between them when entering into the transaction.
- **Complexity:** The sale of a business can often involve a number of complex issues such as delayed payments to the sellers or particular post-completion employment and introduction obligations which are best highlighted at an early stage.
- **Exclusivity:** This keeps both parties focussed on the deal in front of them and can be useful for both parties for different reasons; more often they are to the Buyer's benefit as it avoids them being gazumped but it can be to the Seller's benefit if the Buyer is interested in a few companies within the sector.
- **Instructing advisors:** Legal advice early on can help to ensure the Heads of Terms accurately reflect the overall intention of the parties and allows advisors to provide prompts about matters to be addressed such as warranty periods or post-completion restrictions.
- **Confidentiality:** Heads of Terms provide an early opportunity to bind both parties into confidentiality restrictions which can be critical if customers of the target company are unaware of the potential sale or the buyer does not wish for its potential expansion into a particular area to be public knowledge.

## What should I look out for?

While commonly used, there are situations where Heads of Terms may be less appropriate or can unintentionally cause problems some examples of which are set out below:

- **Restrictive:** Heads of Terms are often agreed before any significant due diligence on a business has been initiated by a buyer and as trading information is shared and risks are identified the original terms may become harder for a prospective buyer to meet.
- **Legally binding:** Generally only certain elements of Heads of Terms under English law are binding, such as confidentiality or exclusivity, however, Heads of Terms prepared under the laws of other countries or without sound legal advice can result in agreeing to obligations that were not intended to be binding.
- **Timeline:** Keeping the sale of a business to a tight timescale can be difficult and dedicating substantial amounts of time and energy to agreeing Heads of Terms may not be appropriate especially where negotiations are ongoing.

Heads of Terms are a very flexible tool when buying or selling a business, providing the opportunity to draw out areas of contention and agree key terms early in the process thereby increasing the likelihood of a smooth transaction. Including legal advisors early on can help to avoid some of the common pitfalls around Heads of Terms and ensure that you are fully aware of what the terms you have agreed mean.

**If you have any questions about Heads of Terms or other aspects of buying or selling a business please do get in touch with us and we would be happy to discuss your questions and how we can assist you.**

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