

BACK TO THE BASICS

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TRANSACTIONS PRACTICE GROUP



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Binding and Non-binding Term Sheets: Drafting v Enforcement

One of the fundamental aspects in every corporate transaction is ascertaining whether the term sheet is intended to be binding or non-binding. Below we discuss the various facets of binding nature of term sheets, from a drafting perspective as well as enforceability perspective.

DRAFTING PERSPECTIVE

- **Non-binding Term Sheet:** While this is the most common position in term sheets, calling this document 'non-binding' term sheet is a misnomer as actually it is a partially binding term sheet. There indeed is express language to indicate that the term sheet would not be binding between parties, as there would be detailed definitive documents in the future. At the same time, typically an exception would be created for clauses like Exclusivity, Confidentiality, Term and Termination, Governing Law and Dispute Resolution, and the like, which would remain binding between the parties.
- **Binding Term Sheet:** As is self-explanatory, a binding term sheet implies all clauses and provisions therein would be binding between the parties. From an enforceability perspective, it has more teeth. Therefore, any definitive documents in the future should clearly have provisions that override this document.
- **Unilaterally Binding Term Sheet:** This is an interesting practice that we sometimes observe, where the term sheet is drafted as a hybrid of the above two models. In other words, for one party it would be non-binding (with the exception of clauses cited above), while for the other party all obligations and commitments would be binding. This is normally done to a party that is perceived to be one that could significantly try to alter principles agreed in the term sheet during negotiations of definitive documents, or for start-ups where at term sheet stage the investor/acquirer does not have sufficient visibility of the facts.

ENFORCEABILITY PERSPECTIVE

- **Judicial evaluation:** Beyond drafting, enforceability is best tested through judicial evaluation. Typically, judicial evaluation of binding value would take place if parties have divergent views on whether the term sheet at hand could be legally enforced.
- **Existence of concluded contract:** A court or an arbitrator may not rely only on the clause stating whether the term sheet is binding or non-binding, and will often look at whether in the term sheet there existed a concluded contract between the parties. If affirmative, there is a stronger case for enforcement. Therefore, it is entirely possible for a non-binding term sheet to be construed as having sufficient agreement between parties and, therefore, being enforceable. Similarly, a term sheet that is silent on binding value (no express clause) may also be construed as concluded contract, thereby making it enforceable.

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