

## Note on Memorandum of Understanding

### I. Introduction

A memorandum of understanding (for short “**MOU**”) is a formal agreement between two or more parties. Companies and organizations can use MOUs to establish official partnerships. MOUs are not legally binding but they carry a degree of seriousness and mutual respect, stronger than a gentlemen’s agreement. Often, MOUs are the first steps towards a legal contract. MOUs are popular in multinational international relations because, unlike treaties, they take a short time to ratify and can be kept confidential. MOUs may also be used to modify existing legal treaties.

### II. Meaning of MOU

MOU describes a bilateral or multilateral agreement between two or more parties. It expresses a convergence of will between the parties, indicating an intended common line of action. It is often used in cases where parties either do not imply a legal commitment or in situations where the parties cannot create a legally enforceable agreement. It is a more formal alternative to a gentlemen's agreement. Whether or not a document constitutes a binding contract depends only on the presence or absence of well-defined legal elements in the text proper of the document. The required elements are namely, offer and acceptance, consideration, and the intention to be legally bound.

### III. How a MOU differs from an Agreement

MOU is used to gauge the intention of the transacting parties before a deal is officially signed between them and doesn't grant either of them any rights. So, in some cases, it may make more sense to opt for a softer, non-legal document than a legally binding one. MOUs are very handy even in matters where the final deal would depend on the fulfilling of certain conditions. For instance, an MOU could be useful while making a real estate deal. Suppose one chooses a house that he/she would like to buy but can only pay for it after six months. In the meantime, one could make a small advance payment and draw up an MOU with the seller stating the terms and conditions from both sides. The house owner may like to include that if he/she fails to make the full payment within six months, he would have the right to refund your money and sell the house to someone else. However, after six months, when the sale actually takes place, he/she would need a more concrete document that is legally binding.

Here's where an 'agreement' comes in. Agreements are usually registered documents that are recognized by courts of law and grant substantial rights to both parties. If either party defaults on the conditions stated in the document, the aggrieved party can file a case for breach of contract.

So, while a pre-nuptial contract is an agreement in most other countries, in India, it can only be a MOU since such documents are not recognized by the Indian courts. So, if marriage doesn't work out, the couple will have to go to court for a divorce and their combined wealth will be divided according to the terms laid down by the court. The pre-nuptial contract will be null and void. Exceptions to the rule however, there are certain exceptions when it comes to the legal validity of a MOU because documentation can become complicated depending on the situation and type of deal. So, a MOU could also be legally

binding depending on the reason for which it has been drafted. This is true in case of a deal related to a monetary transaction. An MOU, does not become legally enforceable just by use of the word 'binding' by the parties.

In situations where registered documents are mandatory, no amount of legal jargon would make a MOU stand up in a court of law. This is why an unregistered MOU has hardly any importance in real estate, and why everyone opts for a notarized agreement, even if it is just to lease out a house for 11 months.

#### IV. Legal enforceability of a MOU

As per the Indian Contract Act 1872, every agreement is not a contract. Only those agreements which are legally binding are contracts and enforceable by the court of law. Section 10 of the Indian Contract Act 1872 lays down the essential requirements of a legally binding agreement or a contract which are as follows:

- a. There must be offer from one party and its acceptance by another
- b. Consent of the parties must be free
- c. Parties must be competent to contract
- d. There must be lawful consideration
- e. There must be lawful object
- f. There must be intention to create legal relations

An MOU might fulfill the first five requirements as mentioned above, but if it lacks the intention to create legal relations, it is not a contract and is incapable of specific performance. The intent of the parties can be deciphered from the contents and the material provision of the MOU. Thus the legal nature of an MOU rests on the rights, duties and obligations it creates among parties. Hence it is very important to understand and appreciate the nature of relationship created by the parties in the MOU.

A distinction has to be drawn on whether the parties intended the MOU be an informal agreement which is an incomplete and merely an agreement to agree or whether it is a complete contract on which the parties consider themselves to be bound.

When parties merely record their understanding with a clause to negotiate and execute a formal detailed agreement in future, such an understanding lacks consideration and intention to create legal relations. Therefore, caution has to be exercised in the language, titles, clauses, etc used while drafting a MOU. Clauses such as jurisdiction clause, applicable law, indemnification have binding effects to the agreement. Similarly the use of the word "shall" will give a binding effect to the MOU and use of the word "should" a non binding effect. Another way in which intention may be displaced is to include a clause in the agreement itself saying that this agreement is not intended to be a contract.

#### V. Precautions while drafting a MOU

Since a MOU cannot be legally enforced, one needs to be careful while drafting it. If anything goes wrong or the other party violates the terms and conditions, one would have no legal recourse or even anybody or any organization that could help the

aggrieved person with the grievance. A non-binding MOU can only be used to show that the other party had agreed to the conditions, but it cannot be used to bring him to book.

In the case of non-binding MOUs, avoid granting a freehand to the other party. For instance, if one party has signed a MOU to give the house to a builder for redevelopment, make sure it does not grant him the right to pull down the property before a final agreement has been drawn. Also, if the MOU is to be annulled after the completion of a certain task or event, it should be clearly stated. Though a MOU is not legally valid, the other person may manipulate it to harass the other party. So, it is best to go through the fine print as with any other document.

## VI. Conclusion

MOU is an important agreement document but enforceability of it depends on the circumstances of the negotiations and terms that the parties have agreed upon in it. MOU's do provide some kind of commitment to the parties but it does not provide 100% certainty to the outcome of the dealing. In MOU, it is important to be aware of the legal and practical implications of the terms of the MOU. MOU may unduly limit future negotiations and impose onerous obligations on the parties.